Department of Corrections

Introduction

The Department of Corrections manages the State's adult correctional facilities and the adult parole system. The Department also operates the Prison Canteens and the Division of Correctional Industries. The canteens provide various personal items for purchase by inmates, including toiletries, snack foods, and phone services. Correctional Industries operates furniture manufacturing facilities, computer manufacturing, a leather products shop, metal fabrication, a print shop, various farming and ranching facilities, Colorado state forms production and distribution facilities, an automotive service station, and the State's license plate manufacturing facility. Correctional Industries also manages the State's surplus property.

The Department's Fiscal Year 2002 operating budget was approximately $517.9 million with 5,969.7 full-time equivalent staff (FTE). Administrative offices for the Department are located in Cañon City and Colorado Springs. Correctional facilities are located throughout the State and include Buena Vista, Canon City, Denver, Pueblo, Limon, Ordway, Delta, Rifle, Golden, Sterling, and Fort Lyons.

The following comment was prepared by the public accounting firm of BKD, LLP, who performed audit work at the Department of Corrections.

Donated Assets

During Fiscal Year 2002 the U.S. Veterans Administration donated a facility to the Department of Corrections that had been operated as a care center for veterans. The facility is located in Fort Lyons, Colorado, and consists of 102 buildings with a total of 579,718 gross square feet. There are 36 significant buildings, 43 employee residences, and 23 miscellaneous support structures. The facility will be converted to a correctional facility with an emphasis on health care services for offenders. It is capable of supporting an inmate population of 1,000.

Government Accounting Standards require that donated assets be recorded at fair value. There was no appraisal conducted on the facility; however, an internal survey of the existing campus was conducted by the Department to establish a value for the facility.

Based on the survey, the Department calculated that the replacement cost of the 102 buildings would be approximately $103 million. However, based on an accumulated depreciation calculation, the actual value recorded on the State's accounting system was $21.5 million. The method used by the Department does not appear to be the best measurement for determining fair value. The Department's method relied on internal estimates of replacement value, rather than on obtaining information that would have reflected the current market value of the donated facility.

Recommendation No. 1:

The Department of Corrections should establish a policy to determine how future donated assets will be valued, including the use of appraisers, when the estimated value of the asset exceeds a specific dollar threshold.

Department of Corrections Response:

Partially agree. The Department of Corrections did not have funds available or appropriated to use a professional appraiser to determine the estimated fair market value of the Ft. Lyons assets donated to the State. Due to a lack of funds for an appraisal (lowest bid was $22,000), the Department internally calculated a fair market value based on outside construction factors, historical prison building costs, and age and condition of the assets. We believe our fair market value calculation of the Ft. Lyons assets was reasonable.

The Department will develop a written internal policy to utilize professional appraisers to value donated assets when the asset fair market value is anticipated to exceed $5 million. The use of appraisers will be subject to funds being appropriated or available for such services. Policy will be written and implemented effective March 1, 2003.

Department of Higher Education

Introduction

The Department of Higher Education was established under Section 24-1-114, C.R.S., and includes all public higher education institutions in the State. It also includes the Auraria Higher Education Center, the Colorado Commission on Higher Education, the Colorado Council on the Arts, the Colorado Student Loan Division, the Colorado Student Obligation Bond Authority, the Colorado Historical Society, and the Division of Private Occupational Schools.

State public institutions of higher education are governed by six different boards. The governing boards and the schools they oversee are:

- **Board of Regents of the University of Colorado**
  University of Colorado at Boulder
  University of Colorado at Colorado Springs
  University of Colorado at Denver
  Health Sciences Center

- **State Board of Agriculture - Colorado State University System**
  Colorado State University
  Fort Lewis College
  University of Southern Colorado

- **Trustees of the State Colleges of Colorado**
  Adams State College
  Mesa State College
  Metropolitan State College of Denver
  Western State College
  Western Colorado Graduate Center

- **State Board for Community Colleges and Occupational Education (SBCCOE)**
  13 Community Colleges

- **Trustees of the University of Northern Colorado**
  University of Northern Colorado

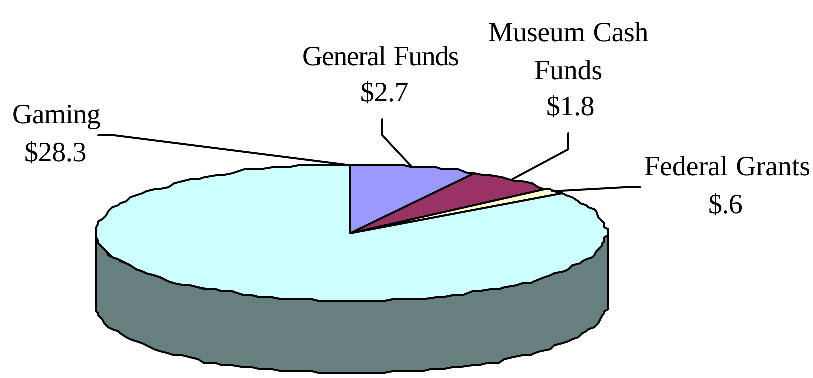
- **Trustees of the Colorado School of Mines**
  Colorado School of Mines

Colorado Historical Society

The Colorado Historical Society, founded in 1879, is statutorily designated as an educational institution in the State. It has exclusive control over the State's historical monuments and in this capacity has the duty to survey suitable sites and structures for historical designation by the State. The Society is charged with administration of a state register of historical properties. It also distributes Gaming revenue to gaming cities through a grant program for historic preservation.

The Colorado Historical Society was appropriated $33.4 million and 104.4 full-time equivalent staff (FTE) for Fiscal Year 2002. Approximately 85 percent of the funding is from Gaming revenue.

Colorado Historical Society
Fiscal Year 2002 Funding Sources
(In Millions)



Source: Joint Budget Committee Fiscal Year 2003 Appropriations Report.

Capital Assets Tracking

State agencies are responsible for ensuring that all capital assets are properly recorded, inventoried periodically, and safeguarded. At June 30, 2002, the Colorado Historical Society had approximately $14.8 million in capital assets, which consist primarily of art and historical treasures, leasehold improvements, and buildings. This included about $695,000 in computer equipment and furniture.

We found that the Society properly recorded the majority of its capital assets. However, the Society has not performed a complete physical inventory of its furniture and computer equipment for the past two fiscal years. According to the Society, the inventory listing of capital assets had many incomplete and ambiguous asset descriptions, making some items difficult to identify and count. Agencies are required to perform a physical inventory at fiscal year-end or at another specified time. Since there are incomplete asset descriptions, it is important for the Society to determine that all of its assets are accounted for properly.

We believe improvements to the Society's controls over computer equipment and furniture inventories would ensure that its capital assets are adequately safeguarded and properly recorded on the State's accounting system.

Recommendation No. 2:

The Colorado Historical Society should perform a complete physical inventory at fiscal year-end or another specified time.

Colorado Historical Society Response:

Agree. We will perform a complete physical inventory on or before June 30, 2003, and at least annually thereafter. We believe the Society's capital assets have been properly recorded on the State's financial system and are appropriately safeguarded through a combination of employee integrity, building security, proper financial recording and physical inventory processes.

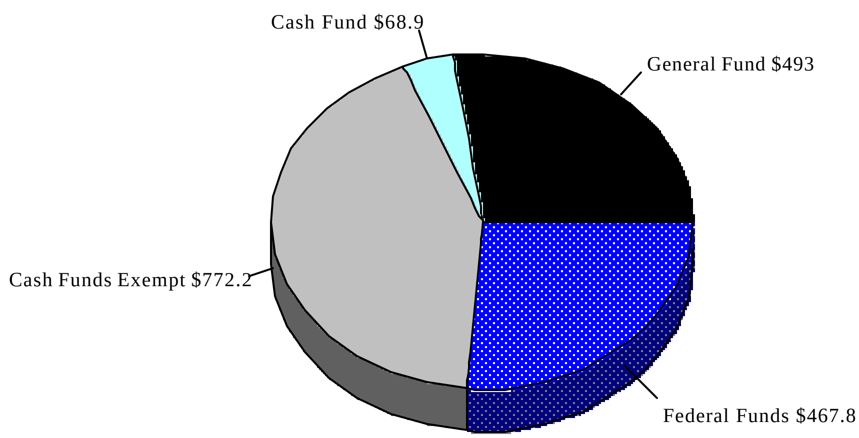
Department of Human Services

Introduction

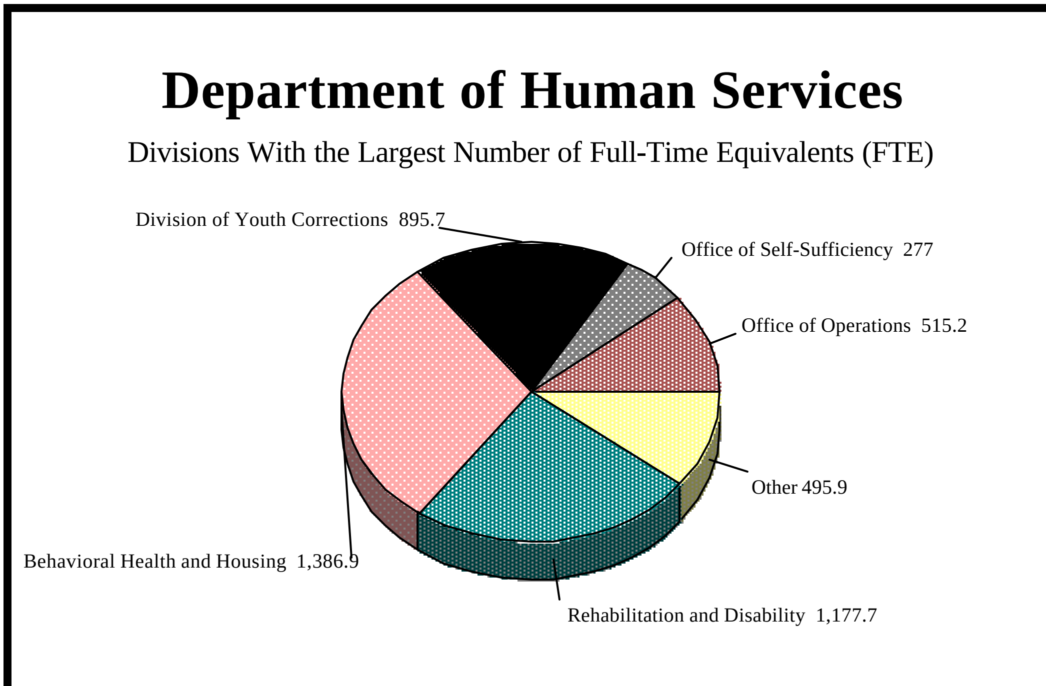
The Department of Human Services was created on July 1, 1994, to manage, administer, oversee, and deliver human services in the State. The Department supervises the administration of the State's public assistance and welfare programs throughout the State. Most of these programs are administered through local county departments of social services. In addition to these programs, the Department is responsible for operating a number of facilities that provide direct services, including mental health institutes, nursing homes, and youth corrections. In Fiscal Year 2002 the Department expended approximately $1.8 billion and had 4,748.4 full-time equivalents (FTE). The following charts show the operating budget by funding source and the divisions/offices with the largest number of FTE, respectively, for Fiscal Year 2002:

Department of Human Services

Fiscal Year 2002 Operating Budget by Funding Source (In Millions)



Source: Joint Budget Committee Fiscal Year 2002 Appropriations Report.



Source: Joint Budget Committee Fiscal Year 2002 Appropriations Report.

We reviewed and tested the Department's internal accounting and administrative controls and evaluated compliance with state and federal rules and regulations. Generally, we found that the Department has adequate administrative and internal controls in place to oversee its operations and meet state and federal requirements. We identified four areas where improvements could assist the Department in effectively managing its responsibilities - one related to financial statement issues and three related to federal awards. Please refer to page 177 in the Federal Awards Findings section for recommendations related to federal awards.

Preparation of Department Exhibits

At the end of each fiscal year, the State Controller's Office requires all agencies to prepare and submit reports, or "exhibits," for use in compiling the statewide financial statements and required footnote disclosures. Exhibits provide information such as significant accounting estimates made by agencies, detailed information on federal receipts and expenditures, and schedules of capital lease payments. Within each department, each agency is responsible for preparing its own exhibits. During our Fiscal Year 2002 audit we tested the exhibits submitted by the 12 agencies within the Department of Human Services and found that in some instances the information reported was not correct.

We tested 68 exhibits submitted by the Department. We noted that 11 of the 68 exhibits contained errors. Specifically, errors or omissions were found on the following exhibits:

- **Reporting for Risk Financing and Related Insurance Issues:** This exhibit reports the detail of agencies' arrangements for insuring against risks. DHS was self-insured for workers' compensation between July 1985 and June 1990 and is required to submit this exhibit for pending or ongoing claims. We found that because Department staff failed to make an accounting adjustment, the Department's liability for insurance would have been understated by approximately $150,000 at June 30, 2002.

- **Schedule of Changes in Long-Term Liabilities:** This exhibit reports the changes in long-term liabilities from the previous fiscal year-end. Out of the 12 agencies within DHS that submitted this exhibit, only 2 submitted the exhibit in the format as prescribed in the Fiscal Procedures Manual published by the State Controller's Office. The remaining 10 agencies indicated they deleted one section of the exhibit prior to submission because they had no information to include in that section. However, this section should have been included because it reports amounts due to other funds, and without the section, it was unclear whether the Department had any amounts to report.

- **Schedule of Capital Leases:** The exhibit reports information on payment schedules for capital assets acquired under lease financing. We noted in two instances that amounts recorded on the exhibit did not agree to the amount reported on the State's accounting system, COFRS. These errors totaled approximately $1,100.

- **Schedule of Federal Assistance:** This exhibit is used for the preparation of the State's Schedule of Expenditures of Federal Awards (SEFA). The SEFA reports all expenditures related to federal grants awarded to the State for the current fiscal year. We identified four errors on the initial and revised exhibits prepared by the Department for its largest agency and one state nursing home. In three cases, expenditures totaling approximately $14,000, $124,000, and $15.5 million, respectively, were classified under the wrong federal program. In the fourth case, the beginning accounts receivable balance was less than the amount recorded on COFRS by $300.

- **Major Accounting Estimates in Excess of $1 Million:** This exhibit provides information for major accounting estimates recorded at fiscal year-end. We found that accounts payable reported on the exhibit were erroneously understated by about $363,000 compared with amounts reported on COFRS.

The Department submitted revised exhibits to the State Controller's Office to correct the identified errors. It is important that the Department improve controls over the preparation of exhibits because this information is the basis for disclosing critical information to users in the footnotes of the State's financial statements, and the submission of revisions can contribute to delays in the timely preparation of the State's financial statements. Improvements would also reduce the need for accounting staff to spend additional time preparing revised exhibits.

Recommendation No. 3:

The Department of Human Services should improve controls over the preparation of fiscal year-end exhibits submitted to the State Controller's Office to ensure that information is accurate and complete.

Department of Human Services Response:

Agree. The Department of Human Services will enforce the procedure to have someone other than the preparer review each exhibit before submission to the State Controller's Office beginning August 1, 2003.

Judicial Department

Introduction

Established by the State Constitution, the Judicial Department is a separate branch of the State's government. The Chief Justice of the Supreme Court is the head of the branch and is responsible for establishing administrative procedures for the following courts:

- Supreme Court
- Court of Appeals
- Trial Courts and Probation
  - 22 district courts
  - 64 county courts
  - 7 water courts
  - 23 probation departments
  - Denver Juvenile Court
  - Denver Probate Court

Several offices and committees within the Department operate outside the direction and control of the State Court Administrator to provide services to the Judicial Department. The Office of the Public Defender provides legal representation for the indigent. The Office of Alternate Defense Council provides representation for the indigent when there is a conflict with the Public Defender representing the individual. The Office of the Child's Representative ensures the provision of legal representation to children involved in judicial proceedings in Colorado.

In Fiscal Year 2002 the Department was appropriated approximately $271.5 million and 3,174.9 full-time equivalent staff (FTE.) The Department receives approximately 80 percent of its funding from the State's General Fund.

The following was prepared by the public accounting firm of Grant Thornton LLP, who performed audit work at the Judicial Department.

Office of the Child's Representative

During the 2000 legislative session, the General Assembly passed House Bill 00-1371, which created the Office of the Child's Representative within the Judicial Department. The

Office is responsible for ensuring uniform, high-quality legal representation and non-legal advocacy to children involved in judicial proceedings in Colorado. This includes enhancing the legal representation of children, establishing fair compensation for services, setting minimum practice and training standards, determining maximum caseloads, establishing oversight committees throughout the State, and working collaboratively with the state court-appointed special advocate (CASA) to develop local CASAs in each Judicial District. The Office has four full-time equivalent staff and is a general funded agency.

Fiscal Year 2002 was the first full year of operations for the Office.

Office of the Child's Representative
Fiscal Year 2002 Expenditures

Expenditure	Amount Expended
Attorney Services - By Type of Case:	
Dependency and Neglect	$5,349,032
Juvenile Delinquency	1,203,240
Domestic Relations	424,682
Truancy	172,982
Probate	89,000
Paternity	78,507
Counsel Expenses	5,286
Other	27,001
Subtotal: Attorney Services	*7,349,730*
Administrative and Operating Costs	449,404
Training	23,938
CASA Contribution	20,000
Total Expenditures	*$7,843,072*

Source: Data obtained from the Office of the Child's Representative.

Attorneys are appointed by judges and magistrates as advocates to represent children's best interests in various types of legal proceedings.

Pursuant to House Bill 00-1371, we reviewed the Office's system of internal controls and examined expenditures. We noted that several key controls had been established, including review and approval documentation, segregation of duties, use of purchase orders for purchases over $5,000, and that fees paid to attorneys were based on the terms of written contracts.

We selected 40 cash disbursements, totaling $179,224, for testing. Thirty-seven attorney payments and three general vendor disbursements were selected. We found that the invoices were in compliance with internal policies, Chief Justice directives, and statutes. The invoices were recorded correctly and in a timely manner on the Court-Appointed Counsel and State's accounting systems. We recalculated hourly bills and agreed contract billings to supporting documentation. We found that invoices contained the proper evidence that they had been reviewed and approved for payment. For attorney disbursements, we reviewed supporting documentation for contract disbursements, noted written verification of appointment, and noted specific written approval for fees requested over the maximum threshold for the type of case. For vendor and other payments, we determined that a W-9 was obtained for new vendors as required by federal law.

We reviewed all Fiscal Year 2002 expense reports submitted by the Board of Directors, Colorado Springs Guardian Ad Litem Office, and the Office's Denver location. We found that all expense reports were properly approved.

We compared total salaries recorded on the State's accounting system with a listing of salaries and contracts by individual. These items were reconciled without exception.

No recommendation is made in this area.

Department of Labor and Employment

Introduction

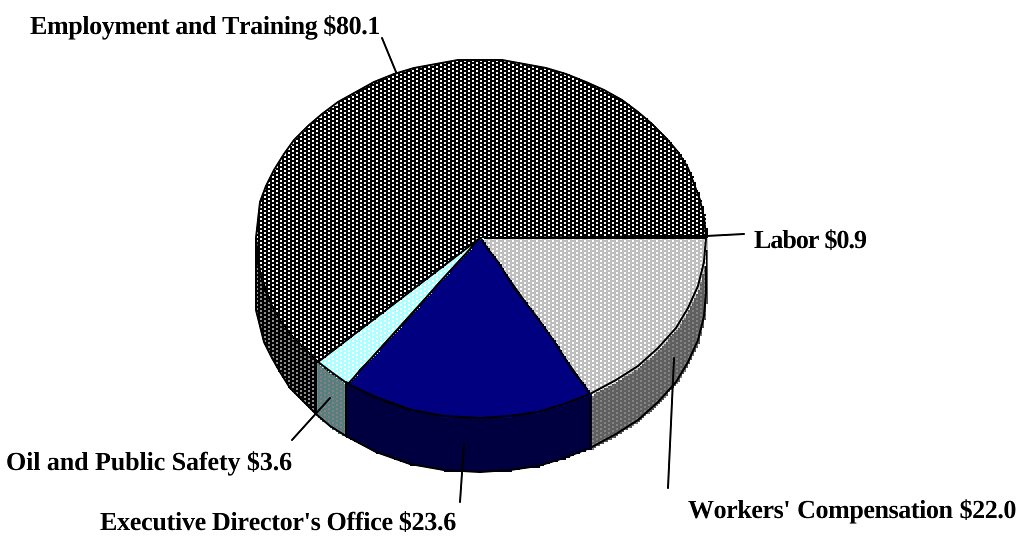
The Department of Labor and Employment is responsible for providing services to employers and job seekers, and enforcing laws concerning labor standards, unemployment insurance, workers' compensation, public safety, and consumer protection. The Department comprises the following major organizational units:

- Division of Employment and Training
- Division of Workers' Compensation
- Division of Oil and Public Safety
- Division of Labor
- Executive Director's Office

The Department was appropriated $130.2 million and 1,035.4 full-time equivalent staff (FTE) for Fiscal Year 2002. Approximately 33 percent of the funding is from cash funds and the other 67 percent is from federal funds. The following chart shows the operating budget by major organizational unit during Fiscal Year 2002.

Department of Labor and Employment

Fiscal Year 2002 Operating Budget by Organizational Unit (In Millions)



Source: Department of Labor and Employment records.

The following comments were prepared by the public accounting firm of Clifton Gunderson LLP, who performed audit work at the Department of Labor and Employment.

Allowance for Doubtful Accounts - Overpayments of Unemployment Benefits

The Department records an accounts receivable to reflect overpayments of unemployment benefits to individuals. These overpayments are for fraudulent and non-fraudulent claims filed and received by persons not eligible for benefits. Fraudulent claims are benefits received as a result of false statements or failure to disclose material facts with the intention of obtaining or increasing unemployment benefits. For example, a fraudulent claim might occur when a person is employed yet is collecting unemployment from a previous job. Non-fraudulent claims are benefits received by a person who unintentionally obtained or increased his or her unemployment benefits. For example, a non-fraudulent claim might occur if a person were receiving severance pay but did not realize this needed to be disclosed on the application for benefits. According to the Department, approximately 30 percent of the current overpayment receivables balance is due to fraudulent claims, and the remaining 70 percent is due to non-fraudulent claims.

The Department collects a portion of these receivables through withholdings of new benefits applied for at a later date by the person who received the overpayment. In these cases, a certain percentage of the new benefits is withheld to repay the overpaid amounts. In addition, Central Collections, within the Department of Personnel and Administration, performs collection services on these accounts, which may result in garnishment of the person's wages. As of June 30, 2002, the Department had recorded about $27.4 million in receivables for overpayments.

The Department records an allowance for doubtful accounts as an offset to the overpayment receivable to reflect the amount it actually expects to collect. The percentage used to calculate this allowance is reviewed annually by the Department. However, we found that the Department has not performed an analysis of actual collections received compared with the percentages used for the allowance calculation for several years.

As of the end of Fiscal Year 2002, the Department recorded an allowance for doubtful accounts of $14.9 million, resulting in a net receivable of $12.5 million (unadjusted). We performed an analysis as part of our audit and determined that the allowance account was understated by $6 million. The understatement was material to the State's financial statements, and the adjustment was made by the Department. When the adjustment was recorded, the net receivable decreased to $6.5 million.

Recommendation No. 4:

The Department of Labor and Employment should perform a comparison of actual collections received for overpayments with the percentages used to adjust the allowance for doubtful accounts on an annual basis and adjust the percentages as necessary.

Department of Labor and Employment Response:

Agree. Beginning in the current fiscal year ending June 30, 2003, the Colorado Department of Labor and Employment (CDLE) will perform an analysis of actual collections received for overpayments in order to determine the correct percentages to use to determine the allowance for doubtful accounts. For the past several years, CDLE's finance office has relied on the manager of the office of Overpayments Collection and Control to provide us an estimate of the probability of collections. The manager's estimate was based on the state of the economy and the unemployment rate, the average time between claims to assess the possibility of offsetting current benefits to recoup prior overpayments, and actual collections rates. Rather than relying solely on the manager's estimate, the finance office will perform its own analysis and use that in conjunction with the manager's estimate to adjust the allowance for doubtful accounts.

Retention of Detail Listing

As stated previously, accounts receivable on overpayments of unemployment benefits relate to fraudulent and non-fraudulent claims filed by persons receiving benefits who were not eligible. According to Section 8-81-101(4)(b), C.R.S., the Department of Labor and Employment may not write off overpayment receivables for seven years in cases of fraudulent claims and five years in cases of non-fraudulent claims, except for certain circumstances such as death or bankruptcy. Due to the amount of time the receivables must be kept, as well as the low collectibility rates, the number of individual overpayment receivable accounts is large. The Department's benefits system produces a new listing on a monthly basis.

Due to the large size of the report, the Department kept only the current month's detail listing. At the time of our audit, the accounts receivable detail listing for this account as of June 30, 2002, could not be located or accessed from the system. Without the detail report, it was difficult to substantiate the accounts receivable balance at fiscal year-end. Therefore, alternative procedures had to be performed. Adequate records must be maintained to support year-end balances.

Recommendation No. 5:

The Department of Labor and Employment should maintain copies of detail listings of all benefit overpayment accounts at fiscal year-end.

Department of Labor and Employment Response:

Agree. At the end of each month, the Colorado Department of Labor and Employment's Overpayment Collection and Control Unit produces both a summary and a detail report of overpayment receivables. Once the reports are deemed to be correct, the prior month's detail report is thrown away. There are multiple reasons for this: the detail report is huge, a hard copy of each claimant's file is kept until any overpayment is fully repaid, the 09 and 14 screens in Colorado Unemployment Benefits System (CUBS) provide overpayment data, the 05 screen provides any payment information, the 20 screen contains any decisions made relevant to an overpayment, and any overpayment can be restored from the CUBS archives if necessary. Effective with the year ending June 30, 2003, and for every year thereafter, the Overpayment and Collection Unit has agreed to maintain a copy of the June 30 overpayment detail report of all benefit overpayment accounts until the annual financial audit has been completed.

Benefits Payable Detail Listing

Benefits payable for unemployment insurance claims are recorded as a liability at the end of the fiscal year on the State's accounting system on the basis of an estimate. The Department of Labor and Employment uses an estimate because it is unable to produce a report of claims filed but unpaid at fiscal year-end by individuals or of claims paid subsequent to the fiscal year-end that were for the previous fiscal year. As a result, the Department cannot determine the actual amount of unpaid obligations that remain at a point in time. This can cause errors with reporting and analysis at any time during the year. In addition, it results in a lack of adequate controls over benefit payments.

As of June 30, 2002, the Department estimated that the amount of benefits payable was $16.0 million. The estimate was based on historical data and actual data during the year. Based on our review, we found that the estimate was reasonable.

The current computer system, the Colorado Unemployment Benefit System (CUBS), is being redesigned and the Department anticipates replacing CUBS with the new “genesis!” computer system. The “genesis!” computer system is intended to have the flexibility to address user requirements.

Recommendation No. 6:

The Department of Labor and Employment should ensure that the “genesis!” system will generate reports listing benefits payable at any point in time and use this information to record benefits payable on the State's financial system.

Department of Labor and Employment Response:

Agree. The Colorado Department of Labor and Employment's (CDLE) current Colorado Unemployment Benefits System (CUBS) is not able to produce a report giving Finance the amount of Unemployment Insurance (UI) benefits payable at any given time, nor is it able to extract the amount of UI benefits paid in any period that were applicable to a previous reporting period. This makes the estimate of UI benefits payable difficult and also prevents CDLE Finance from comparing the estimate to actual after the fact. The new UI Compensation system ("genesis!") will have the capability of producing both reports. The new system will be able to produce a report that will give CDLE Finance a listing of UI benefits payable as of the end of a quarter. It will also allow CDLE to run a report showing the UI benefits paid in the subsequent quarter that were applicable to the prior quarter. CDLE finance will be able to compare the accrual to actual and adjust future accruals accordingly to ensure a reasonably accurate UI benefits payable accrual. The UI benefits portion of "genesis!" is on target to be rolled out by April of 2004. CDLE should be able to implement this recommendation for fiscal year-end June 30, 2004.

Information Systems Reconciliations

The Department of Labor and Employment has several information systems applications in addition to the State's accounting system. One of these systems is the workers' compensation system used to track information for the Subsequent Injury Fund, the Major Medical Fund, and the Medical Disaster Fund. Expenditures in those funds totaled $16.0 million, $219.4 million, and $5,800 respectively for Fiscal Year 2002.

The reconciliation between the State's accounting system and the workers' compensation system was not completed until two months after year-end closing for Fiscal Year 2002. We reviewed the reconciliation and found no problems for Fiscal Year 2002. However, the delay of the reconciliation could result in material differences between the two information systems that may not be found until after fiscal year-end close. We noted that although it is the Department's policy to make these reconciliations on a monthly basis throughout the year, it did not perform the reconciliations during Fiscal Year 2002 until after year-end.

Recommendation No. 7:

The Department of Labor and Employment should ensure that reconciliations between all workers' compensation information systems and the State's accounting system are performed on at least a quarterly basis throughout the year and that any discrepancies between systems are resolved on a timely basis.

Department of Labor and Employment Response:

Implemented. The accounting technician who reconciles the workers' compensation system to the State's accounting system has recently gained access to all the monthly COFRS and Workers' Compensation reports required to perform the reconciliation. The technician is currently reconciling the two systems for the period of July through December 2002, and will perform the reconciliation on a monthly basis from this point on.

Department of Natural Resources

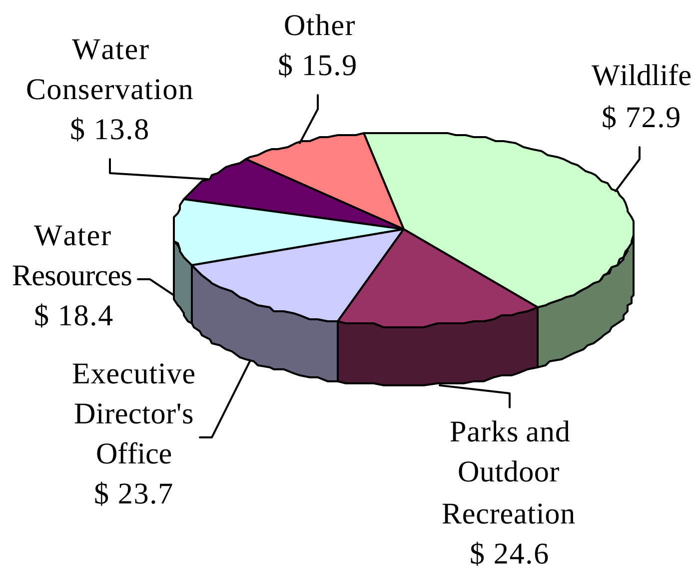
Introduction

The Department of Natural Resources is responsible for encouraging the development of the State's natural resources. Resources include land, wildlife, outdoor recreation, water, energy, and minerals. The Department operates under the authority of Section 24-1-124, C.R.S. The Department comprises the Executive Director's Office, which is responsible for the administration and management of the overall Department, and the following eight sections:

- Wildlife
- Water Resources
- State Board of Land Commissioners
- Parks and Outdoor Recreation
- Oil and Gas Conservation Commission
- Division of Minerals and Geology
- Water Conservation Board
- Geological Survey

The Department's Fiscal Year 2002 operating budget was about $169.3 million with 1,515.3 full-time equivalent staff (FTE). The Department is primarily cash-funded. Revenue sources include hunting, fishing, and other licenses; royalties and rents; interest; and other sources. The following chart shows the Department's operating budget by division, board, and commission for Fiscal Year 2002.

Department of Natural Resources
Fiscal Year 2002 Budget by Division /Board/Commission
(In Millions)



Source: Joint Budget Committee Fiscal Year 2003 Appropriations Report.

Procurement Cards

In Fiscal Year 2001 the Department of Natural Resources began using procurement cards. These are credit cards issued to approved staff for making purchases for Department business. Charges made with the card are the liability of the Department unless the cardholder violates the terms of the card's use. Each cardholder's supervisor acts as an approving official who is responsible for ensuring cardholders comply with the Department's procurement card policies. Spending limits are established by a cardholder's approving official in conjunction with the Department procurement card administrators and are based on the purchasing needs of the employee. The spending limits range from $500 to $3,000.

The Department's Procurement Card Guide outlines policies and procedures for the use of procurement cards as well as responsibilities for both cardholders and their approving officials. Some of these policies include requiring the cardholder and the approving official to review and sign the card statements on a monthly basis as well as requiring the cardholder and approving official to sign an agreement indicating that they will comply with all terms of the cards.

As of June 30, 2002, about 275 Department employees had procurement card privileges. During Fiscal Year 2002 the Department made purchases totaling about $793,000. During our audit we selected a sample of 25 employees who had procurement cards and reviewed one monthly statement for each employee selected. We found several problems with 21 of the 25 employee statements reviewed, or 84 percent of the sample. Specifically, we found the following:

- **Seven instances in which monthly statements were not reviewed by the cardholder and/or approving official.** The Department's procurement card policies are intended to ensure that all purchases on the statements are appropriate. In addition, the approving official's review ensures that adequate documentation has been maintained to support all purchases. When a review of the statement is not performed, the risk increases that non-business-related purchases may be paid for with state monies. After our audit, these statements were subsequently reviewed by the Department's procurement card administrators, and expenditures were determined to be appropriate.

- **Sixteen supervisors for whom the Department did not have an Approving Official Procurement Card Agreement on file.** By signing the approving official agreement form, the supervisor indicates that they understand their responsibilities as the approving official. These responsibilities include reviewing monthly card statements and obtaining supporting documentation from the employee for all purchases. In addition, the approving official is responsible for submitting the appropriate coding to Department accounting staff to ensure that charges are allocated to the correct appropriations and accounts for payment.

- **Two employees for whom the Department did not have a Cardholder Procurement Card Agreement on file.** By signing the cardholder agreement form, the employee indicates that they understand their responsibilities as the cardholder. These responsibilities include maintaining supporting documentation for all purchases; reviewing monthly statements; and following applicable statutes, rules, policies, and procedures for each card purchase.

In addition to the procurement card policies mentioned above, the Department has a policy that requires review of all procurement card purchases made by every Department cardholder every six months. Any problems noted during the review of the card statements are to be documented and presented Department-wide to ensure that instances of purchasing mistakes or misuse are not repeated at any division within the Department. During our audit we found that reviews are not routinely performed. Specifically, the Department has not performed any reviews for the past year and a half.

The Department should take steps to improve the administration of the procurement card program to ensure that state funds are spent appropriately. Enforcing these requirements should reduce the risk of errors or irregularities.

Recommendation No. 8:

The Department of Natural Resources should improve the administration and monitoring of the procurement card program by ensuring that:

a. All monthly procurement card statements are reviewed and signed by both the employee and the approving official.

b. All employees and approving officials have signed cardholder agreement and/or approving official forms.

c. Reviews of procurement card statements are performed in accordance with policy.

Department of Natural Resources Response:

Agree.

a. As the current Department audit for Fiscal Year 2002 is being conducted, each cardholder and his/her approving official is being contacted to remind them to sign the statement. Also, a letter went out to all cardholders and approving officials in September 2002 reminding them of their responsibilities as participants in this program.

b. The letter sent to cardholders and approvers in September included agreements to be signed and returned. A new database has been developed to track these agreements.

c. The audit of the procurement program was delayed due to the loss of an FTE in the Accounting/ Purchasing Section. The Purchasing Director has taken on the responsibility of auditing the procurement cards, in accordance with the current audit policy, for Fiscal Year 2002. When this is accomplished, the audit plan and policy will be revised to require a more reasonable review to include random samples, particularly for cardholders that have demonstrated that they are complying with the requirements. This should result in more timely review and audit of cardholder statements.

Implementation date: March 31, 2003.

Capital Assets Tracking

The Department is responsible for ensuring that all capital assets are properly recorded, inventoried periodically, and safeguarded. Most of the Department's $201 million in capital assets are located at various parks and wildlife facilities throughout the State. Assets include land, improvements to land, buildings, leasehold improvements, equipment, library books, historical treasures, and infrastructure. Examples of infrastructure include roads, bridges, and dams. Under a new governmental accounting standard effective in Fiscal Year 2002, the Department is required to capitalize certain long-lived assets and depreciate them over their estimated useful lives.

However, during our audit we found the following problems with how the Department accounts for its inventory of land, buildings, leasehold improvements, and infrastructure:

- **The Department has not performed an annual physical inventory at all of its locations.** The Division of Wildlife did not complete a physical inventory of its $140 million in capital assets. If a physical inventory is not performed, there is a risk that State assets are not adequately safeguarded and that assets are not accurately reported on the State's accounting system.

- **The useful lives assigned to capital assets are not reasonable.** The Department established useful lives of 27.5 years for all buildings purchased before 1975 based on general guidelines established by the State Controller's Office. While the State Controller's guidelines suggest a useful life of 27.5 years for buildings, the guidelines also suggest that the estimated useful life of a capital asset is a function of each agency's experience. By assigning useful lives of 27.5 years to its older buildings, the Department has not taken into account its own experience. Experience would suggest that the buildings are expected to be in use past Fiscal Year 2002. Several state agencies assigned useful lives of 100-plus years to their buildings.

- **For costs of building and leasehold improvements, the Department inappropriately established a useful life beyond the useful life of the original asset.** The end of the useful life of the improvement should coincide with that of the original asset. For example, if an addition is made to an existing building, the estimated remaining useful life of the addition should be the same as the building it improved.

- **The Department capitalized many items that are below the State's established capitalization criterion of $50,000.** For example, about half of the Department's 216 buildings had historical costs of less than $50,000 and in total amounted to only $3.3 million of the Department's $47.6 million in buildings, or less than 7 percent. At the Division of Wildlife, 80 buildings had historical costs of less than $50,000 and in total amounted to only $2.9 million, or 11 percent of the Division's $25 million in assets. While the Department may establish lower thresholds based on its own experience, the Department has in effect established no threshold. The value of buildings should be tracked for insurance purposes. However, it is an unnecessary use of staff resources to track and record depreciation on these relatively low-cost structures.

In addition to concerns regarding the need to safeguard assets and appropriately report financial information on capital assets, we are particularly concerned about the valuation of the capital assets at the Division of Wildlife. The General Assembly designated the Wildlife Cash Fund fund balance as part of the TABOR emergency reserve for Fiscal Year 2002. Of the Division's $179 million fund balance, $140 million relates to investments in capital assets. Therefore, the completeness and accuracy of the amounts recorded as capital assets is especially important. If these assets are not accurately reported, there is the risk that there may be an insufficient reserve for TABOR purposes.

Recommendation No. 9:

The Department of Natural Resources should improve its controls over capital assets by:

a. Performing an annual physical inventory at all of its locations.

b. Establishing reasonable useful lives for original assets and additions to those assets based upon its own experience and documented assumptions and ensuring that the useful lives of improvements are the same as or less than the original asset.

c. Raising its capitalization thresholds to the levels recommended by the State Controller's Office, or establishing other reasonable thresholds based upon documented experience.

d. Making the proper adjustments to the State's accounting system based upon the results of its physical inventory, its review of established useful lives, and its reevaluation of capitalization criteria.

Department of Natural Resources Response:

a. Agree. Since the Department's physical assets are located at sites all around the State, the responsibility of conducting the physical inventory is assigned to the manager in charge at each location. Reminders and requests for physical inventories are sent to each manager by the DNR central accounting staff. Follow-up notifications are also sent when responses are not received by a specified date. Prior to Fiscal Year 2002, the Deputy Director of the Department would notify the Division Directors of any managers who did not respond after the second notification. With changes in EDO staff in Fiscal Year 2002, this practice was not followed. DNR accounting will recommend new procedures in Fiscal Year 2003 to ensure compliance with the annual inventory requirement. To be implemented June 30, 2003.

b. Agree. Since this was the first year of calculating depreciation and the Department had no prior basis for determining useful life or the actual condition of buildings, the Department opted to follow the State Controller's guidelines for useful when calculating depreciation. Having completed development of a capital asset database in Fiscal Year 2002, additional refinements will be made to better identify a more accurate useful life as well as identifying and tracking specific improvements to specific buildings, a process which has never been done in the past. To be implemented June 30, 2003.

c. Partially agree. The current Department practice of capitalizing assets whose value is less than the State Controller's threshold allows the Department to efficiently ensure that property owned by the Department is accurately categorized and valued for reporting to Risk Management for insurance purposes by using one single database. This has been the historical practice of the Department and has been continued through the implementation of GASB 34. Since the database performs all the calculations for depreciation, it was found that this practice did not create a significant or unnecessary workload issue. The Department will analyze and assess the implications to the Risk

Management reporting and insurance coverage that may result from implementing the recommendation. Assessment to be completed by June 30, 2003.

d. Agree. To be implemented June 30, 2003.

State Board of Land Commissioners

The five-member volunteer State Board of Land Commissioners is responsible for managing three million surface acres and four million mineral acres of state lands for the benefit of eight separate trusts. For Fiscal Year 2002 the Board was appropriated approximately $2.9 million and 33 FTE. Sources of funding included leases, timber production, land sales, mineral royalties, bonuses, and interest.

Surface Leases

The Board rents lands to private parties for agricultural, recreation, tower site, and commercial purposes. The leases typically last for 10 years, and the original lessee often renews the lease for another 1 to 10 years. For Fiscal Year 2002 the Division collected rents totaling about $603,000 on 2,615 active surface leases.

We reviewed the Board's process for billing lessees and recording rental income. We found that the Board did not bill lessees for 55 surface leases, totaling $270,000, from Fiscal Years 1995 through 2001. In addition, the Board did not record a receivable for the amounts due until Fiscal Year 2002. As a result, revenue was understated in prior years and overstated in Fiscal Year 2002 by this amount.

In each of these instances, the leases expired but the remaining tenant continued to utilize the land. The rent was not billed because the Board believed that it could not bill current lessees once the lease had expired. The Board's policy was to bill for these back rents once the lease was renewed, which could be two or more years later. The Board has since obtained informal legal guidance indicating that it could bill the "hold-over tenants" at the old lease rate until the lease had been renewed. However, the Board has not yet billed these tenants as of November 2002.

This delay in billing was primarily caused by a significant backlog in the lease renewal process. The 55 leases expired between 1995 and 2001 and have not yet been renewed. In July 2001 the Department hired a consultant to look at the lease renewal process. The consultant made several suggestions for streamlining the process, some of which the Department has implemented or intends to implement. For example, the Department has begun utilizing an economic scorecard that addresses high-risk factors such as credit history and financial position of the lessee. According to the Board, it has reduced the time it takes to renew a lease from an average of 64 weeks to an average of 25 weeks.

If the Board does not bill tenants in a timely manner, there is a risk that the Board will be unable to collect back rent, especially if the lease is not subsequently renewed.

Lease Management System

The Board receives about 2,500 lease rental checks each month averaging about $50,000 each month. These rental checks are currently processed on the Surface Lease Management System (SLIMS).

During Fiscal Year 1999 the Land Board purchased a lease management software system from Utah's Land Board for approximately $100,000. The goal was to put the new State Asset Management (SAM) system in place in October 2000. The system was designed to provide management with more accurate, timely, and detailed information on leases. However, as of October 2002, the new system had not been implemented.

Recommendation No. 10:

The State Board of Land Commissioners should improve its surface lease procedures and systems through the following:

a. Continuing to streamline its lease renewal process in order to reduce or eliminate the backlog.

b. Billing for back rents on expired leases based upon the “hold-over tenant” concept.

c. Recording revenue in the proper fiscal year.

d. Implementing the new State Management System (SAM) system as soon as possible.

State Board of Land Commissioners Response:

Agree. The State Board of Land Commissioners (SLB) agree with the recommendation in total and have already begun implementing the specific details of the recommendation including:

a. A detailed evaluation and streamlining of the lease renewal process, which has reduced and will eventually eliminate lease processing backlog. Implemented September 1, 2002.

b. Creating a new process for hold-over tenant billing to allow the SLB to capture revenue and record it in the proper fiscal year. To be implemented by June 30, 2003.

c. The implementation of the above two concepts has allowed the SLB to record revenue received for these two processes in the appropriate fiscal year. Implemented September 1, 2002.

d. The State Management System (SAM) has been successfully implemented and is in the process of being de-bugged. To be implemented by June 30, 2003.

Division of Wildlife

The Division of Wildlife manages over 250 wildlife areas covering 300,000 acres. The Division acquires habitat lands, conducts research, and enhances the public's awareness of relevant wildlife issues. The nearly one and a half million hunting and fishing licenses sold annually provide the majority of the Division's funding. In Fiscal Year 2002 the Division was appropriated approximately $73 million and 753 FTE.

GOCO Billings

As required by the Colorado Constitution, Lottery proceeds are allocated to the Great Outdoors Colorado (GOCO) for preserving, protecting, enhancing, and managing the State’s wildlife, park, river, trail, and open space heritage. The Constitution requires GOCO to then distribute these funds to various entities including the Division of Wildlife.

During Fiscal Year 2002 the Division expended approximately $7.1 million on GOCO projects, primarily in the form of grants for habitat and species protection, watchable wildlife, and education projects. According to a memorandum of agreement between GOCO and the Division, "the Division shall submit monthly billing statements to the GOCO board identifying total expenditures to date, along with the amount of GOCO funds currently due for the work completed. Within 30 days of their receipt, the GOCO board shall reimburse the Division in accordance with the monthly billing statement . . . ."

In our October 1999 performance audit of the Division of Wildlife, we found that the Division does not consistently request reimbursement for its grant-related expenditures from GOCO on a timely basis. During our current audit we found that the Division had not billed for expenditures totaling $2.8 million for the months of April, May, and June until September 2002. By the Division's not requesting reimbursement more timely, we estimate that it lost interest of approximately $18,000. In addition, the Division did not provide GOCO with the critical financial information regarding year-end liabilities. During our current year audit of GOCO, we also found one billing due to the Division for March 1999 expenditures that had not been paid as of the end September 2002. Consistent monthly billings and a review of an aging of accounts receivable by the Division could have prevented the missed payment.

The Division operates on a cost-reimbursement basis with GOCO, meaning it must request reimbursement for its expenditures after they are made rather than in advance. Therefore, it is important that the Division request reimbursement as soon as possible after expenditures have been incurred.

Recommendation No. 11:

The Division of Wildlife should request reimbursement for its GOCO-related expenditures on a monthly basis.

Division of Wildlife Response:

Agree. The Division of Wildlife billed for reimbursement from GOCO for all months during the fiscal year except the months noted in the audit report. The delay for the billings was caused by directing resources to ensuring that $12 million of personnel expenditures for the Division were posted properly in a new time tracking system by the close of the fiscal year. The Division intends to resume monthly billings effective immediately. Implemented January 31, 2003.

Cancelled Payments

During Fiscal Year 2002 the Department issued about 241,000 payments to individuals and vendors. The majority of these payments, about 207,000, were for limited license refund checks. The remaining 34,000 were for routine vendor payments and property damage payments to ranchers.

In prior years' audit, we found problems with duplicate payments at the Division of Wildlife. We recommended that the Department of Natural Resources strengthen internal controls over processing and reviewing payments to prevent payment errors. We continued to find similar problems during our current audit. In Fiscal Year 2002 the Division cancelled about 122 payments totaling approximately $502,000 due to problems with the original payment voucher.

We reviewed 25 cancelled payments totaling about $70,000 to determine the reason for the cancellation.

- **We found that 6 of the 25 cancelled payments, or about $1,000, were sent to the wrong vendor and were returned to the Department.** The checks went to the wrong vendor because the vendor code was incorrect on the original payment voucher. The addresses were corrected and the checks were subsequently reissued. Vendor codes are listed on the State's accounting system, along with the vendor name and address, so that the State can track total payments to each vendor for Form 1099 federal tax reporting purposes. Procedures were not in place at the Division to regularly update or confirm that vendor codes are current. Outdated vendor records could result in sending a payment voucher to the wrong vendor or address. This increases the risk that the payment will be lost and have to be reissued. It could also delay the timeliness of vendor payments. State Fiscal Rules consider a payment delinquent if not made within 45 days after the liability arises. As such, the Department could be at risk of owing interest to the vendors.

- **The reason for cancellation was not documented for 12 of the 25 payments, totaling about $68,000.** Upon further research, the Department determined that three had been sent to the wrong vendor and four had been lost in the mail. The Division could not provide us with explanations for 5 of the 25 cancelled payments. Therefore, we could not determine whether the cancelled payments were appropriate. In our prior audit, we also found that the Division did not always document the reason warrants were cancelled on the original payment voucher.

Continued problems with cancelled payments at the Division of Wildlife increases the risk of errors and irregularities and indicates the need for stronger management controls over processing and reviewing payments.

The Department of Personnel has estimated that it cost the State $25 to process each payment voucher. We estimate that the 122 cancelled warrants at the Division cost the State an additional $3,050 in processing costs during Fiscal Year 2002.

Recommendation No. 12:

The Division of Wildlife should improve controls to reduce the number of cancelled payments by:

a. Ensuring vendor information is correct before issuing payments to vendors.

b. Documenting the reason for cancelling a warrant on the original payment voucher.

c. Determining the reason for recurring problems with payment vouchers and strengthening management controls to prevent them from occurring in the future.

Division of Wildlife Response:

Agree.

a. All Division of Wildlife employees who enter or approve payment vouchers in COFRS receive four hours of training from the Department of Natural Resources accounting section. One of the points of the training is to ensure that the vendor name and address on the payment voucher match the vendor invoice. The payments identified in the audit report were to common vendors such as Walmart with multiple addresses, which can easily cause confusion. The Division of Wildlife will reinforce upon employees with COFRS access to carefully verify the correct vendor and address. To be implemented March 1, 2003.

b. Warrants for vendor payments are cancelled and reissued by the Department of Natural Resources accounting section on behalf of the Division of Wildlife as a separation of duties control for this process. For payments under $1,000, the Department of Natural Resources does not have the original payment voucher, since they are paid by the remote offices throughout the

Division of Wildlife. Therefore, for these payment vouchers under $1,000, the Department of Natural Resources will file a photocopy of the original payment voucher with the reason for cancellation noted. The Department of Natural Resources will institute a new policy for requesting cancellation and/or reissue of warrants that will require significantly more complete information and documentation from the agency prior to the warrant being cancelled. Under this new policy, all divisions within the Department will review, approve, and log all requests for warrant cancellations prior to submitting to the Department Controller for action. The Divisions will be expected to monitor their cancelled warrants and analyze reasons for cancellations and to take appropriate actions to remedy problem areas. The Department will notify the State Controller's Office not to accept any warrant cancellation requests that do not conform to this new policy. To be implemented March 1, 2003.

c. The Division of Wildlife cancelled less than 1 percent of the payment vouchers that were issued. The cancelled payments occur for a variety of reasons and many of them are unique, one-time occurrences. The Division of Wildlife will reinforce the importance of accurate vouchering to all employees who have been assigned COFRS access and will take appropriate actions where recurring problems are found to exist. These actions may range from requiring additional training to loss of vouchering input or approval authority. To be implemented March 1, 2003.

Department of Personnel and Administration

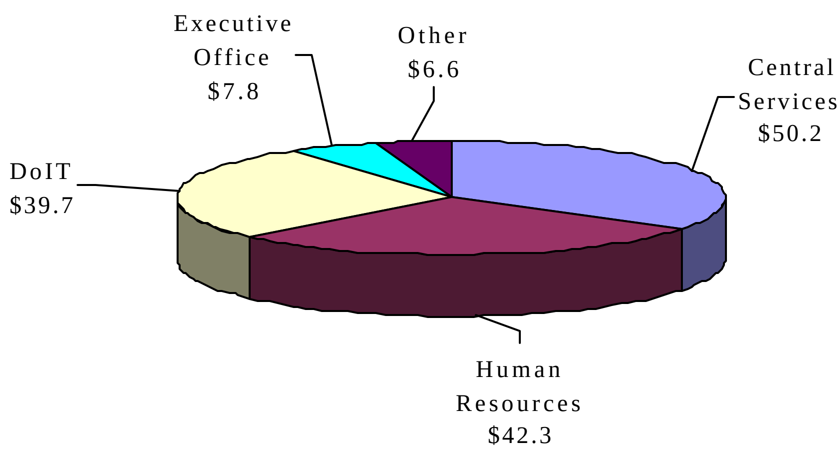
Introduction

The Department of Personnel and Administration's primary function is to support the business needs of state government. The Department administers the classified personnel system, which includes approximately 28,000 full-time employees, (excluding the Department of Higher Education), and provides general support services for other state agencies. The Department of Personnel and Administration includes the following divisions:

- Executive Office
- Human Resources
- Personnel Board
- Central Services
- Finance and Procurement
- Information Technologies (DoIT)
- Administrative Hearings

The Department was appropriated total funds of $146.6 million and 589 full-time equivalent staff (FTE) for Fiscal Year 2002. Approximately 9.7 percent of the funding is from general funds and 90.3 percent is from cash funds. Cash funds include, but are not limited to, vehicle and building rentals, copying, printing, graphic design, and mail services. The following chart shows the operating budget by division during Fiscal Year 2002.

Department of Personnel and Administration
Fiscal Year 2002 Operating Budget by Division
(In Millions)



Source: Joint Budget Committee Fiscal Year 2003 Appropriations Report.

Payroll Processing

In Fiscal Year 2002 the Department of Personnel and Administration had an actual annual gross payroll of approximately $26.6 million for its 528 full-time employees and an annual gross payroll of approximately $1.2 million for its 46 part-time employees. During our Fiscal Year 2002 audit we reviewed controls over the monthly and biweekly payroll process. We found three problems as follows:

- Payroll duties were not segregated. One employee directly associated with processing payroll was also reconciling the payroll expense. This employee was also responsible for entering, reviewing, and correcting payroll information without supervisory review.

  The same problem existed during our Fiscal Year 2001 audit. The Department agreed the payroll process duties should be segregated and moved this function from the Division of Human Resources to the Executive Office where the Department believed there was adequate staff to allow for the proper segregation. However, during our current audit, we found that the duties were still being performed by one employee. Duties related to review of payroll should be separated from those related to data entry functions. Segregating duties in the payroll area is essential for reducing errors and controlling irregularities.

- Withholding documentation contained inconsistencies or was missing information. We reviewed 60 employee files and found nine instances where the marital status and/or the number of personal allowances to be taken on the W-4 (tax withholding) form did not agree with the information on the Colorado Payroll Personnel System. We also found one instance where the W-4 was missing from the employee's file. However, the Department had entered tax withholding information into the Colorado Payroll Personnel System for this employee.

- Biweekly payroll contained calculation errors. We reviewed the manual biweekly payroll calculations for one pay period for 32 employees. Ten out of the thirty-two employee biweekly calculations were incorrect. In total, the employees were underpaid by approximately $275 in gross pay. These errors occurred in the manual calculation of shift differential and overtime pay. We found the Department's internal reconciliation process detected nine of the underpayments. These errors were corrected in the pay period immediately following the payroll in which the errors occurred. One error was not detected until we brought it to the Department's attention. These errors could have been detected earlier if a supervisory review had been in place prior to payroll distribution.

- Compensating controls are inadequate. In our Fiscal Year 2001 audit report, we recommended that all divisions receive and review their payroll expense reports and that each division confirm the accuracy of its monthly and biweekly payroll. This was to compensate for the lack of segregation in the payroll processing section. During our current audit we found that the Department provides the divisions with payroll expense reports, which include the employee's name; gross amount of salary; and number of regular, overtime, and shift differential hours. While the division payroll liaisons were reviewing payroll expense reports to determine whether employees were valid, they were not reviewing the regular, overtime, and shift differential hours worked.

Recommendation No. 13:

The Department of Personnel and Administration should improve the payroll function by:

a. Segregating the payroll processing and reconciliation duties.

b. Reviewing employee personnel files and reconfirming that withholding documentation is accurate and complete.

c. Implementing adequate supervisory reviews over the payroll calculation.

d. Ensuring adequate compensating controls are in place if payroll duties are not segregated.

Department of Personnel and Administration Response:

a. Agree. To be implemented March 1, 2003. Vacancies and turnover in the Executive Office have prevented the Department from providing the proper segregation of duties in this area. Staffing has stabilized and we are now in the process of designing, documenting, and implementing adequate controls over payroll. In addition, we will be performing quarterly internal audits of the payroll function. Based on the findings of these audits, procedures will be refined and implemented as necessary.

b. Agree. Implemented September 2002. Each department employee was required to submit updated W-4 data to the Executive Office. This information was then used to update all personnel files within the Department.

c. Agree. To be implemented March 1, 2003. The Department is implementing internal controls over the payroll function that include an independent review of payroll calculations. In addition, we will be performing quarterly internal audits of the payroll function. Based on the findings of these audits, procedures will be refined and implemented as necessary.

d. Agree. Implemented January 2003. Procedures have been refined to allow for adequate compensating controls. Payroll liaisons throughout the

Department independently review monthly and biweekly payroll expense distribution reports to ensure employees are paid appropriately.

Procedures and Controls Over Payment Vouchers

Central Collections, an agency within the Department of Personnel and Administration, is responsible for collecting debts owed to state agencies and local governments and disbursing collections to them. The agency's internal debt collection system, Columbia Ultimate Business System (CUBS), managed 670 client agencies and 867,000 accounts totaling $650 million as of June 30, 2002. In Fiscal Year 2002 Central Collections collected nearly $10.5 million in debts owed and made payments to entities in the amount of $8.7 million. The difference of $1.8 million represents collections fees to Central Collections and private collection companies.

The Department's central accounting staff within the Executive Office (EO) is responsible for reviewing supporting documentation, such as detailed billing information, and approving disbursements of payments to state agencies and local governments. We found that the EO approved Central Collection's payments without reviewing supporting documentation. The same problem existed in our 2001 audit, and at that time the EO agreed to implement procedures to review supporting documentation before approving payments. During our Fiscal Year 2002 audit, EO staff reported that they had asked Central Collections to attach supporting documents to all payment vouchers submitted for approval. However, due to the large volume of documentation required to support individual payment vouchers, Central Collections was not submitting all the documentation necessary to enable EO to determine if a payment was appropriate.

According to EO staff, the Department has considered alternative procedures for determining the appropriateness of payments related to Central Collections, such as conducting periodic internal audits of Central Collections, establishing segregation of duties among staff within Central Collections to allow the agency to approve its own payments, or a combination of both. However, as of the end of our audit, the Department had not implemented alternative procedures. Although we did not find errors related to Central Collections payments during our Fiscal Year 2002 audit, the Department should establish a method for determining the appropriateness of Central Collections payments in order to mitigate the risk of errors.

Recommendation No. 14:

The Department of Personnel and Administration, Executive Office, should implement procedures to review Central Collections' supporting documentation prior to approval of payments.

Department of Personnel and Administration Response:

Agree. To be implemented July 1, 2003. The Department of Personnel and Administration is in the process of developing an internal audit function. The first audit to be performed is that of Central Collections. Internal controls will be tested and weaknesses identified. Adequate controls will then be designed and implemented.

Risk Management Revenue

We found that the Department of Personnel and Administration, specifically Risk Management, a service unit within the Division of Human Resources, did not properly classify revenue on the State's accounting system for inclusion in the TABOR revenue base. In our Fiscal Year 1999 audit, we found similar problems, and Risk Management subsequently made improvements. However, during our current audit we found similar problems.

The Division of Risk Management collects premiums from state agencies for the administration of the State's Risk Management Program. We reviewed the amount of premiums received and found that Risk Management incorrectly recorded monies received from the Division of Wildlife, a division within the Department of Natural Resources. This error resulted in an overstatement of TABOR revenue of approximately $704,000. Revenue was adjusted before the TABOR Schedule of Revenue was finalized.

In order to classify revenue received from state agencies and enterprises correctly, the Department of Personnel and Administration requests certain TABOR information from those agencies it bills for Risk Management services. It is the Department's responsibility to obtain this information to ensure revenue is reported accurately. Since excess TABOR revenue is required to be refunded to taxpayers, the accuracy of the revenue classifications is critical.

Recommendation No. 15:

The Department of Personnel and Administration should properly classify revenue for TABOR purposes.

Department of Personnel and Administration Response:

Agree. Implemented July 2002. Procedures have been modified to ensure that revenues are correctly classified on a monthly basis.

State Controller's Office

Introduction

The State Controller's Office is within the Division of Finance and Procurement in the Department of Personnel and Administration. The Office is under the direction of the State Controller, who is appointed by the Executive Director. The State Controller's Office manages the financial affairs of the State by providing financial information, issuing fiscal policies, ensuring timely recording of the budget, and providing accounting consulting services to state agencies.

Cash Flows

The State Controller's Office coordinates and compiles data from state agencies for inclusion in the State's financial statements. A required statement is the statement of cash flows for business-type activities, such as the State Lottery, Unemployment Insurance, Student Obligation Bond Authority, and higher education institutions. This statement provides information about the sources of cash and how it was spent. Users of the financial statements may use this information to look for trends that may indicate strengths and weaknesses in the ability of state agencies and institutions to finance their operations or to repay debt.

During Fiscal Year 2002 the State Controller's Office fully implemented Governmental Accounting Standards Board (GASB) Statement No. 34. The Statement establishes new financial reporting requirements for governments. Its implementation has created new information and has restructured much of the information that has been presented in the financial statements in the past. This was the first year in which a statement of cash flows was required for higher education institutions. The statement of cash flows is made up of four categories (operating activities, noncapital financing activities, capital and related financing activities, and investing activities), which are defined in GASB Statement No. 9.

Certain state agencies separately issue financial statements. We compared the State's statements with the separately issued statements and found that information presented on the State's statements did not agree to the separately issued financial statements for the higher education institutions and the Student Obligation Bond Authority as follows:

- **Inconsistencies in reporting presentation were identified between the State's statements and the higher education institutions' statements.** We found that the State Controller's Office generally classified transactions relating to gifts and donations from foundations and other private sources, certain student financial aid transactions, and certain distributions to other colleges as cash flows from operating activities; the higher education institutions treated these same items as cash flows from noncapital financing activities. The reporting differences can be attributed to interpretation differences of GASB Statement No. 9. The higher education institutions reported gifts of approximately $72.8 million in the cash flows from noncapital financing activities section, while on the State's financial statements only $1.3 million of gifts are reported this way, with the remainder reported as cash flows from operating activities. For certain student financial aid transactions (e.g., Direct Lending Program), the State's financial statements report cash inflows of $379.3 million and cash outflows of $380.5 million (with a net difference of about $1.2 million) as operating activities, while the higher education institutions report such cash inflows and outflows as noncapital financing activities. The Colorado Community College System's financial statements show $25.9 million as distributions to other colleges as cash flows from noncapital financing activities, while this amount is reported as cash flows from operations on the State's financial statements.

  Many of these inconsistencies in the statement of cash flows were also classified differently in the statement of revenues, expenses, and changes in fund net assets.

- **Differences were identified between the State's statement of cash flows and the Student Obligation Bond Authority's.** When comparing the Student Obligation Bond Authority's (CSOBA) statement of cash flows with the State's, we found a $32 million difference in cash because the definition of cash used by the agency was different from what was prescribed by the State. CSOBA included investments in money market funds in its definition of cash, while the State does not. In addition, there were several other smaller differences between the two sets of statements. In prior years we have had similar problems with the statement of cash flows, and have requested that the State Controller's Office work with CSOBA to ensure there would be agreement between presentation of amounts on the financial statements. As a result of our audit, changes had been made to the State's and the agency's financial statements. To provide the most accurate presentation in the future, during the State's financial statement preparation process, the State Controller's Office, in conjunction with CSOBA, should identify, resolve, and provide adequate detail to resolve differences between the State's and the agency's separately issued financial statements.

In order to enhance the usefulness and comparability of the statements, the State Controller's Office, higher education institutions, and CSOBA need to come to an agreement on how to categorize accounting transactions on the statement of cash flows and the statement of revenues, expenses, and changes in fund net assets.

Recommendation No. 16:

The State Controller's Office should refine the methods used to compile the statement of cash flows and the statement of revenues, expenses, and change in fund net assets by:

a. Working with higher education institutions to develop a consistent interpretation of Governmental Accounting Standards Board Statement No. 9 to be used in categorizing accounting transactions in the statement of cash flows.

b. Assisting the Student Obligation Bond Authority to ensure that transactions are properly categorized and reported.

State Controller's Office Response:

Agree. Implementation date September 20, 2003.

Department of Regulatory Agencies

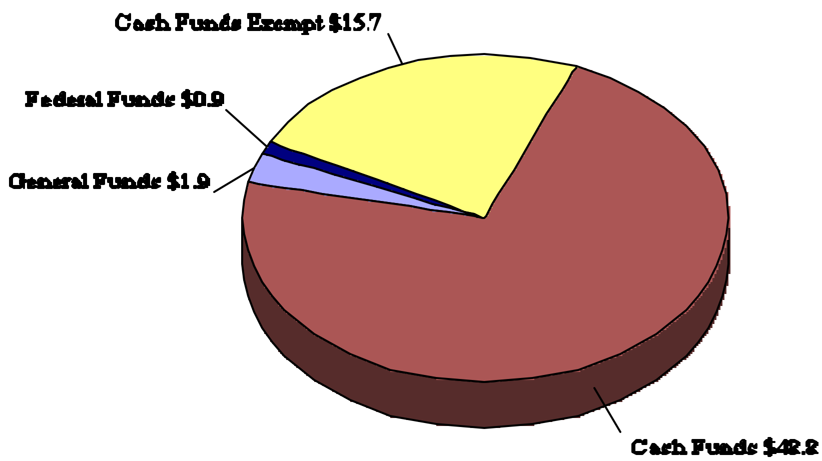
Introduction

The Department of Regulatory Agencies oversees professionals and industries. The Department of Regulatory Agencies includes the following ten divisions:

- Executive Director's Office
- Division of Banking
- Civil Rights Division
- Office of Consumer Counsel
- Division of Financial Services
- Division of Insurance
- Public Utilities Commission
- Division of Real Estate
- Division of Registrations
- Division of Securities

The Department of Regulatory Agencies was appropriated $67.3 million and 534 full-time equivalent (FTE) staff for Fiscal Year 2002. Approximately 96 percent of the funding is from cash funds and cash funds exempt sources.

Department of Regulatory Agencies
Fiscal Year 2002 Funding Sources (In Millions)



Source: Joint Budget Committee Fiscal Year 2003 Appropriations Report.

Management Controls Over Revenue

The Department is primarily funded from cash fees, and it is important that it establish and maintain strong management controls over revenue. The Department's numerous and varied fees are recorded in 10 divisions and in 39 separate cash funds. Each division and commission within the Department is responsible for collecting, depositing, and recording its fee revenue. The Office of Accounting and Purchasing is to ensure that each division and commission has properly accounted for its fees.

As part of our audit, we reviewed the Department's process for recording revenue. We found that the Department did not record revenue in the Disabled Telephone Users Fund in the proper fiscal year. The Disabled Telephone Users Fund within the Public Utilities Commission is statutorily authorized to collect a surcharge of 10 cents per line per month in accordance with the "Americans with Disabilities Act of 1990." Revenue was about $4.3 million in Fiscal Year 2002 and about $3.4 million in Fiscal Year 2001.

The Department did not record revenue or a receivable of about $280,000 on the State's accounting records until about 11 months after it was received and deposited by the State Treasurer, or until January 2002. In addition, although one company owed its June 2001 payment of about $250,000 at the end of Fiscal Year 2001, the Department did not record revenue or a receivable to reflect this at June 30, 2001. As a result, revenue and the accounts receivable in the Disabled Telephone Users Fund were understated by $530,000 in Fiscal Year 2001, and revenue was overstated in Fiscal Year 2002 by about $530,000.

Neither the Public Utilities Commission nor the Department has established adequate analytical review procedures to detect errors. For example, a comparison of revenue between similar accounting periods by division and commission would help ensure that errors such as this do not occur in the future. If the Department had compared revenue for the Disabled Telephone Users Fund between fiscal years, it might have noted the decrease, performed further investigation, and made the proper corrections before the accounting records were closed for the year.

Recommendation No. 17:

The Department of Regulatory Agencies' Office of Accounting and Purchasing should establish and maintain analytical review procedures over revenue for the Department's divisions and commissions and investigate significant variations.

Department of Regulatory Agencies Response:

Agree. The Department's Office of Accounting and Purchasing is in the process of establishing and maintaining analytical review procedures over revenue and other accounts Departmentwide, which will include investigation of significant variances followed by corrections on COFRS if necessary. The new Department Controller and Assistant Controller have recently attended training from the State Controller's Office on the Financial Data Warehouse. The use of this financial reporting tool will assist in conducting variance analysis periodically during the fiscal year in avoidance of this type of error in future fiscal years. These steps should establish and maintain strong management controls over revenue and other accounts. Implementation date January 2003.

Department of Revenue

Introduction

The Department of Revenue is responsible for managing the State's tax system. Tax collections totaled $8 billion in Fiscal Year 2002. Of this amount, about $6.4 billion represents collections for the General Fund; the remainder represents collections made on behalf of entities such as local governments and for the Highway Users Tax Fund. In addition, the Department is responsible for performing various other functions as follows:

- Administer the State Lottery, which grossed nearly $408 million in ticket sales in Fiscal Year 2002. Of this amount, about $110 million was available for distribution for capital construction as well as for parks and outdoor projects.

- Act as a collection agent for city, county, RTD, special district, and severance taxes. The Department received over $900 million in taxes and fees on behalf of other entities.

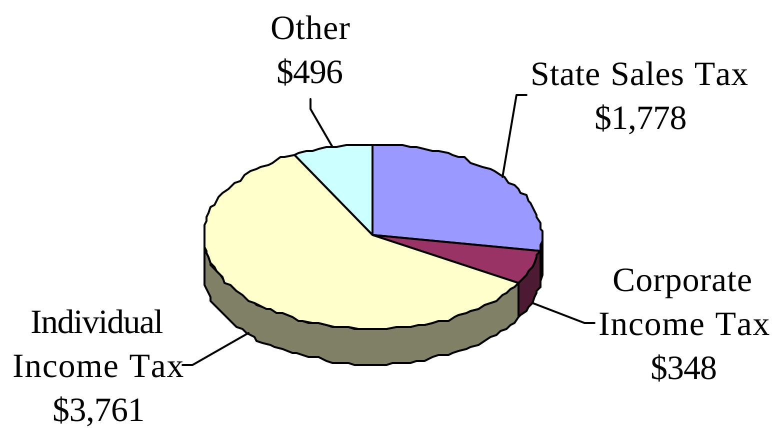
- Collect taxes and fees for the Highway Users Tax Fund (HUTF), which is primarily for the benefit of highway maintenance projects in the State. In Fiscal Year 2002, amounts collected for the HUTF totaled approximately $729 million.

- Regulate the limited stakes gaming activities in Cripple Creek, Black Hawk, and Central City. In Fiscal Year 2002 the Limited Gaming Division reported about $99.8 million in revenue.

- Enforce tax, alcoholic beverage, motor vehicle, and emissions inspection laws.

- Operate the State's 11 Ports of Entry.

Department of Revenue
General Fund Revenue Collections
(In Millions)



Source: Department of Revenue, Fiscal Year 2002 Collections Report.

In Fiscal Year 2002 the Department had a budget of over $539 million and 1,527 full-time equivalent staff (FTE).

TABOR Refund Mechanisms

The Taxpayer's Bill of Rights (TABOR) was added as Article X, Section 20, of the Colorado Constitution in the November 1992 general election. TABOR limits increases in the State's revenue to the annual inflation rate plus the percentage change in the State's population. Revenue in excess of this limitation must be refunded to taxpayers in the following fiscal year unless voters approve a revenue change that allows the State to keep the excess. TABOR also allows the State to use tax credits as a mechanism to refund the excess revenue.

For Fiscal Year 2002 there were 15 credits used to refund the $927.2 million Fiscal Year 2001 TABOR excess. These included the state earned income credit; the business personal property tax credit; the dividend, interest, and capital gains exemption; the capital gains modification; the rural health care provider credit; increased child care credits; the foster parent credit; the health benefit plan credit; motor vehicle registration fees; interstate commerce sales and use tax exemption; income tax deduction for charity; agriculture value-added account credit; individual development accounts credit; the high-technology scholarships credit; and the state sales tax refund.

In our prior year audit, we found problems with several of the different TABOR credits, specifically relating to the rural health care provider credit, the earned income credit, the health benefit plan credit, and the business personal property tax credit. In addition, we found that required documentation was not submitted showing eligibility of the taxpayer for the different credits. During the current fiscal year, we continued to find problems with the TABOR refund mechanisms.

TABOR Credits

Many of the credits require the submission of documentation in addition to the standard return that shows that a taxpayer is eligible to take the credit. Others restrict eligibility by the amount of a taxpayer's federal adjusted gross income. We examined 205 income tax returns in 6 different samples, each relating to 1 of the 15 TABOR refund mechanisms. The credits claimed in these tax returns totaled $1,733,932.

The types of errors identified in the sample continue to be similar to those found during the previous two fiscal years' audits. Evaluation of the sample identified $248,902 in credits that were either erroneously granted to ineligible taxpayers or that could not be supported by required documentation. Overall, we found problems in 54, or 26 percent, out of the 205 income tax returns that were sampled (some taxpayers' returns had more than one problem and appear in more than one category below). Specifically, we found:

- **9 out of the 10 taxpayers claiming the rural health care provider credit were not eligible for the credit.** We reviewed 10 taxpayers who claimed $11,113 in the rural health care provider credit and found that only one individual was certified. Individuals are statutorily required to be certified by the Department of Public Health and Environment (DPHE) to take the rural health care provider credit. Certification is available to health care professionals who reside and practice in areas of Colorado that are understaffed; these health care professionals can take a credit of up to one-third of the amount of qualified student loans. The certification form was missing in 9 of the 10 tax returns sampled, and these 9 taxpayers did not provide student loan information on which the credit calculation is based. In addition, we compared a list of certified taxpayers from the DPHE with a report showing all taxpayers who claimed the credit and found that 251 out of the 267 taxpayers were not certified. These 251 taxpayers took credits totaling $172,099 and included the 9 we noted in our sample. We found similar problems in our Fiscal Year 2001 audit. In response to our recommendation, the Department stated that it would investigate a programming change to verify that the taxpayer has a certificate; however, this change was not made. During our current audit we found that the Department did perform a cross-check of the individuals that claimed the credit and those that were certified by the DPHE. However, this cross-check was done after the taxpayer's return had been processed and the taxpayer received the credit. Therefore, the Department had to subsequently bill the taxpayers that were found to have received the tax credit in error.

- **13 out of the 25 taxpayers claiming the health benefit plan credit were ineligible for the credit.** We sampled 25 taxpayers who took health benefit plan credits totaling $9,558 and found that 13 out of 25, or 52 percent of taxpayers sampled, had federal adjusted gross income in excess of the threshold. The credits issued in error totaled $4,980. Individuals with a prior year federal adjusted gross income of less than $35,000 are eligible to take the health benefit plan credit. The credit allows taxpayers to claim a credit for health benefit plans not paid for by an employer or deducted from federal adjusted gross income. During our Fiscal Year 2001 audit, we found similar problems. In response to our recommendation, the Department stated that it would investigate developing a computer edit in Fiscal Year 2002 to verify last year's federal adjusted gross income; however, this new edit was not implemented. In addition, we found that eight taxpayers did not provide the amount of the premium paid for the qualifying health plan.

- **20 out of 145 taxpayers did not include the Colorado Individual Credit Schedule or the Colorado Source Capital Gain Affidavit.** We found that the Colorado Individual Credit Schedule was not submitted in 10 out of 120 instances when required for the credits we sampled, and the Colorado Source Capital Gain Affidavit was not submitted in 10 out of 25 instances in our sample of the Colorado Source Capital Gain Exclusion. These 20 taxpayers claimed credits totaling $62,965. During both of the last two fiscal year audits, we found that taxpayers did not always submit the schedule or affidavit. The schedules are required by the Department to provide detail to support certain tax credits claimed; however, the Department does not enter the information from the forms into Revenue's accounting system. The Department will process returns without the required Schedule or Affidavit.

- **12 out of the 25 taxpayers claiming the child care credits provided incomplete dependent information.** We sampled 25 taxpayers who claimed child care credits totaling $13,732 and found that 12 taxpayers either did not submit dependent information or submitted inaccurate information. These 12 taxpayers claimed credits totaling $8,858 and had one problem or more with reporting the child care credits. There are three different child care credits that may be claimed by a taxpayer with an adjusted gross income of less than $64,000. The per child credit is $300 for children under five years of age; the family home care credit is allowed for taxpayers that are licensed to run a family home care facility and is $300 per child for children between 6 and 13; and the child care credit is 70 percent of the federal child care credit claimed less any amount that is claimed for the per child and/or family home care credits. All three of these credits require that taxpayers submit information about the eligible child, including date of birth and social security number. This information is documented as part of the Colorado Individual Credit Schedule. During our audit we found that 11 taxpayers did not provide the required dependent information, including 8 taxpayers who submitted an electronic return. In addition, we found three taxpayers claimed the family home care credit for more children than listed on the Schedule. Finally, we found one instance where a taxpayer claimed a credit for a dependent who was older than the maximum age requirement. In all of these instances, the Colorado Individual Credit Schedule was either not submitted or contained inaccurate information, based on eligibility requirements. As mentioned above, the Department does not verify that information from this Schedule is complete and accurate.

It is clear that the Department lacks systems for verifying a taxpayer's federal adjusted gross income at the time a credit is granted. Fair Share, a division within the Department, receives federal tax information from the federal government in order to verify the accuracy of state tax information. However, this information is not received by Fair Share until after the majority of the taxpayers have already filed returns and received the TABOR credits. Additionally, the Department does not ensure that supporting documentation is submitted with the return. Such documentation is already required by statute or the Department's own instructions. Without this documentation, the Department cannot verify the eligibility of taxpayers to take the credits. Because there is no methodology in place to verify eligibility, individuals who were not eligible to take these credits were able to claim them. The Department needs to conduct testwork to determine eligibility, and thereby identify and bill all ineligible individuals who claimed these credits erroneously.

We have identified other instances in which the Department lacks processes for ensuring taxpayers' eligibility for income tax credits. In our Enterprise Zone Program Performance Audit issued in November 2002, we found controls lacking over the issuance of enterprise zone credits. As we reported at that time, we found ineligible taxpayers claiming enterprise zone credits for which they were not certified because the Department did not verify eligibility. The Department should work on developing additional controls over TABOR credits to ensure that adequate controls are in place once the TABOR credits become effective again. One option the Department should consider is to enter data from supplemental documentation that is required to support certain tax credits claimed, such as the Colorado Individual Credit Schedule, into Revenue's accounting system. This will ensure that all required documentation is submitted before the return is processed. Another option is for the Department to develop additional edits in its computer system to verify the accuracy of the credit. Our audit clearly indicates the need for additional procedures and controls to be developed for future TABOR refunds in order to ensure that only eligible individuals receive the credits.

Recommendation No. 18:

The Department of Revenue should develop controls to ensure that future TABOR credits are claimed and received only by eligible individuals by:

a. Identifying and billing individuals who were ineligible to claim TABOR credits.

b. Implementing a methodology to verify taxpayers' federal adjusted gross income at the time a credit is claimed and to ensure that taxpayers are eligible for the credits taken.

c. Processing only complete returns, or evaluating alternative methods of ensuring that only qualifying credits are claimed, should the taxpayer fail to submit the required schedules.

Department of Revenue Response:

The Department's approach for determining TABOR credit eligibility reflects resources that have been provided principally as a result of fiscal notes or decision items. Eligibility reviews during processing typically require more resources than reviews after processing. Thus, the Department's TABOR eligibility reviews, including timing and methods, are based on the resources that have been provided and the specific criteria for each credit. With respect to the specific recommendations in the audit report, the following comments are offered:

a. Agree. As part of its normal processing and compliance practices, taxpayers found to have improperly claimed any TABOR credit are currently billed by the Department for any additional tax liability resulting from denial of their claim. This billing currently occurs whenever the improper claim is identified.

The timing of this billing may differ depending on the nature of the credit, its eligibility parameters, and the specific processing and compliance techniques employed for any particular credit. The Department will continue its current practices in this regard.

With respect to the sampled returns and any other erroneous credits claimed, the Department will make a final review, issue bills, and begin collection activity. This process is in accordance with current department policies and procedures regarding improperly claimed credits. This review and billing will be completed by March 31, 2003.

b. Partially agree. For TABOR credits tied to current year Federal AGI, verifying cannot be accomplished until the IRS provides the information many months later. If future year legislation requires dependence on verification of prior year AGI, the Department will request appropriate resources to satisfy the recommendation.

c. Agree. The Department will develop and adopt formal policies and procedures to ensure that compliance alternatives and associated costs are identified and disclosed during the fiscal note process. The Department will further evaluate the feasibility, including costs, to identify during processing those tax returns claiming credits that require attached tax forms or third-party documentation. The evaluation will include the impact on processing cycles and taxpayer compliance. This evaluation will be completed by December 31, 2003.

Manual Adjustments to Tax Returns

The Department data enters information from taxpayers' returns into its income tax accounting system (ITAS). The actual returns submitted are microfilmed and retained by the Department. However, once the tax information is entered into ITAS, the system information becomes the official record of the tax return. The system captures various information, such as the taxpayer's account history and TABOR credits. It is also used by the Department to assess additional tax due and refund excess income tax revenue collected from taxpayers.

For some income tax returns, the data posted to the ITAS differ from that submitted by a taxpayer. These differences result from the Problem Resolution Unit (PRU) resolving potential error conditions arising from edits applied by the system to the data entered from a taxpayer's return. Processing of a tax return cannot be completed until the edit conditions are resolved. In order to resolve the edits, PRU staff make manual adjustments to taxpayer information on ITAS. During our testwork of TABOR credits, we found that the Department needs to improve controls over manual adjustments to ensure that the adjustments are appropriate. Specifically, we identified an instance in which a charitable contribution deduction for about $7.1 million was entered by Department staff when the taxpayer did not claim the deduction on his return. The overstatement of the charitable contribution deduction caused the TABOR liability on the State's financial statements to be understated by about $327,000 as of June 30, 2002. The taxpayer's liability was not affected by the charitable contribution deduction, because the Department had made other offsetting changes on the return.

On the basis of our review and discussions with Department staff, we determined that the Department's internal controls over manual adjustments were lacking in the following areas. First, the Department does not have adequate reviews in place for returns that report adjusted gross income of $10 million or more. Limitations in the Department's accounting system do not permit the Department to enter dollar values of $10 million or more on a single line. If a taxpayer's income exceeds this limit, procedures state that Data Entry staff should enter the taxpayer's income as $9,999,999 and enter all other information on the system as it appears on the return. We noted that the Department does not routinely review data entered into its system for returns that report income of $10 million or more. These returns are a high-risk area for the Department due to the amount of dollars involved and the necessity for manual intervention. The Department should require an independent review of all data entered for these returns.

The second area where controls are lacking concerns the absence of an independent review of manual adjustments made by PRU staff to ensure that adjustments made are appropriate. For the item in our sample, the taxpayer's income in the Department's system was understated by about $2 million ($12 million on original return less $9.9 million posted by staff). This caused the system to flag the return because the system's calculated tax liability did not agree with the liability entered from the original return. When the return was sent to PRU, staff made adjustments in the system, including changing the charitable contribution deduction from zero to $7.1 million, which "forced" the calculated tax liability to agree to what was on the taxpayer's original return. Since there was no change in the taxpayer's original liability, no independent review was performed of the changes. In this case, however, the change made by PRU staff caused an inappropriate decrease in the TABOR liability of $327,000 on the State's financial system. Since the charitable contribution is a deduction from taxable income, the TABOR effect is calculated by multiplying the deduction entered with the state tax rate of 4.63 percent. The ability to make manual changes creates a risk of errors and irregularities occurring. The Department should develop procedures to mitigate this risk and detect improper changes.

Finally, we found that the Department does not have sufficient controls over system-generated letters that are to be sent to the taxpayer in cases where manual adjustments result in a change of the tax refund due or liability owed. The standard letter details the adjustments made to the return so that the taxpayer can review and respond to the changes made. The Department stated that the taxpayer in our sample was sent a standard letter; however, the Department could not provide a copy of the letter because copies are not maintained. In addition, we found that the Department tax examiner who enters the adjustment on the return also has the ability to override the system so that a letter is not sent to the taxpayer. The Department should have procedures in place to ensure that taxpayers are notified of all adjustments made to tax returns and that taxpayer notification is not inappropriately overridden by staff.

Recommendation No. 19:

The Department of Revenue should enhance controls over manual adjustments made to taxpayer returns by:

a. Performing reviews of data entered into its system on all returns with income of $10 million or more.

b. Developing procedures for reviewing manual adjustments to tax returns made by the Problem Resolution Unit.

c. Ensuring that staff making manual adjustments to tax returns do not improperly override system-generated letters to taxpayers.

Department of Revenue Response:

a. Agree. The Department recognizes that current system limitations that necessitate exceptions or "work arounds" to standard procedures create greater opportunity for processing error, although the extent of the potential risk is unknown. The underlying problem of the outdated income tax system is the systemic cause of this problem. System changes will be made to flag returns where Line 1 is filled with nines, along with new procedures requiring supervisory review of them. This change can be implemented by January 1, 2004.

b. Agree. Adjusting taxpayer submitted data to ensure compliance with state statutes and conformance with supporting documentation is a vital part of the Department's procedures from a processing and compliance perspective. The taxpayer's original return is microfilmed and is available if corrections to the electronic record (where adjustments are reflected) are necessary. The Department will assess the risk associated with the edit resolution work performed by PRU staff. The overall objective of the study will be to determine, using valid statistical sampling, the potential "error rate" in tax returns adjusted for the 2001 tax year. Priorities for applying resources, including new and/or expanded procedures to address any identified risk to the Department's accounting system, will be developed and implemented. Assuming adequate computer resources will be available, this project will be completed June 2004.

c. Agree. The Department agrees that processes should be in place to determine if employees are improperly over-riding system controls. Specifically, determining that letters are not being improperly suppressed will be tested as part of the special study described in "c" above. Assuming adequate computer resources will be available, this project will be completed by June 2004.

Charitable Contribution Deductions

The charitable contribution deduction began as a TABOR refunding mechanism in Calendar Year 2001. Under statutes, this mechanism allows taxpayers who do not itemize deductions on their federal income tax return to deduct all but $500 of their charitable contributions on their state income tax return. The charitable contribution refund is claimed by taxpayers as a subtraction from federal taxable income in order to determine the Colorado taxable income. Taxpayers claimed a total of about $58.8 million in charitable contribution deductions on Calendar Year 2001 returns submitted from January 1, 2002, to October 31, 2002.

During our audit we requested that the Department provide a report detailing all taxpayers who claimed more than $20,000 for the charitable contribution deduction. This report showed that 41 taxpayers claimed a deduction of greater than $20,000 between January 1 and October 31, 2002. These deductions totaled about $4.3 million and ranged from $20,000 to $1,676,924. Because the Department does not have a method in place to verify that the taxpayers did not itemize deductions on their federal tax returns, we could not determine whether the charitable contribution deductions claimed by the taxpayers were valid. In total, if it is found that all 41 taxpayers erroneously claimed the charitable contribution deduction, the State will have received approximately $198,000 less in income tax revenue.

In most instances, taxpayers itemize deductions on their federal tax return if the total amount of those deductions exceeds the standard deduction. Itemized deductions include such items as charitable contributions, medical and dental expenses, state and local taxes, and mortgage interest. The amount of these deductions, subject to certain limitations, is then deducted from gross income in determining a taxpayer's taxable income. The standard deduction ranges from $3,800 to $7,600 depending on the taxpayer's marital status and other factors, with additional deductions allowed for taxpayers age 65 or older and those that are blind. The maximum standard deduction, with additional deductions, that is available to a taxpayer is $11,200. Therefore, it is likely that an individual who has over $20,000 in charitable contributions would itemize his or her deductions on the federal tax return. The Department should have some process in place to verify that taxpayers claiming the charitable contribution deduction did not itemize on their federal return and therefore are eligible for the deduction on their Colorado return.

Currently the Department does not have edits in place over the charitable contribution deduction during the processing of returns. The Department does review all income tax returns with refunds over $3,000, and some returns are stopped for random audits. Therefore, if the taxpayer claimed the charitable contribution deduction, but did not have a refund of greater than $3,000, the tax return would most likely not be reviewed by the Department. The Fair Share Section within the Department receives federal tax information from the federal government after returns are filed that can be used to review the validity of Colorado income tax returns. However, Fair Share is not planning to review Calendar Year 2001 tax returns until January 2004 and has not determined whether the charitable contribution deduction will be subject to review.

The Department should consider additional procedures to ensure that credits claimed by taxpayers are reviewed. One option is to have Fair Share review all charitable contribution deductions over a certain dollar threshold.

Recommendation No. 20:

The Department of Revenue should develop and implement procedures to review charitable contribution deductions claimed by taxpayers.

Department of Revenue Response:

Partially Agree. It is not possible to verify at the time of processing whether taxpayers have claimed on their federal return the standard federal deductions because the IRS information necessary to make this verification is not available to the Department until several months after returns are processed. By July 1, 2004, the Department's Fair Share audit section will develop a pilot project using federal information to evaluate the propriety of these deductions.

Moreover, the Department will implement an up-front processing edit to deny this deduction if a taxpayer also claims an addition to Colorado taxable income for state income taxes paid. The state income tax add-back should be made only when the taxpayer does not take the federal standard deduction, but taxpayers sometimes mistakenly include this add-back, even though they have claimed only the federal standard deduction. Therefore, while this edit may have some use as a screening device, the edit cannot be used to verify that the taxpayer claimed only the federal standard deduction.

The charitable contribution deduction is available only in years when there is a TABOR surplus. The Department will implement the processing edit when there are tax years when there are TABOR surpluses.

Personal Property Tax Refunds

The personal property tax refund began as a TABOR refund mechanism in Fiscal Year 1999. This mechanism allows qualified taxpayers to claim a refund of personal property taxes paid to all taxing jurisdictions in Colorado. In Fiscal Year 1999 all qualified taxpayers were required to submit a paper return and proof of payment to claim the refund; this resulted in the Department's having to manually process more than 100,000 property tax returns. House Bill 00-1145 changed the process by allowing the refunds to be processed automatically on the basis of information provided to the Department by both county treasurers and county assessors. During our Fiscal Year 2001 audit, we found that information provided by the counties was inaccurate, resulting in the Department's having to process more than 2,800 returned checks. House Bill 01-1287 modified the administration of the credit by requiring that one set of information be provided from the county assessor and treasurer, instead of each submitting separate reports. During Fiscal Year 2002, approximately 81,000 refund checks, totaling about $101.6 million, were issued to taxpayers as a result of the personal property tax refund.

In our Fiscal Year 2001 audit, we found several problems with the personal property tax refund process, specifically that (1) there were more than 3,100 outstanding, or uncashed, refund checks; (2) data entry errors on taxpayer information were made by the Department; and (3) as noted above, some counties were unclear on the information that was to be provided to the Department. We noted improvements during our current year audit. Most of the improvements occurred because 54 of the 63 counties submitted electronic reports in Fiscal Year 2002, compared with 25 counties in Fiscal Year 2001, which reduced the number of data entry errors by Department staff. The Department also implemented new edits to verify the accuracy of data entry for the amount of tax paid and the number of schedules submitted. However, we continued to find outstanding refund checks.

During our current audit we found that there were more than 2,400 checks, totaling about $2.1 million, that were outstanding as of November 4, 2002. Among these checks, 39 were related to the Calendar Year 2000 refund checks, totaling about $269,000. The Department stated that these 39 checks were reissued to the taxpayer; however, the checks were not cashed. The remaining outstanding checks were part of the Calendar Year 2001 refunds and ranged from $1 to $169,155. The majority of these checks were issued on a single day, October 29, 2001. Of these, there were 461 checks that were greater than $500 each. The 10 largest checks ranged from $28,081 to $169,155 and were issued to major corporations that should be easily located. The Department reports that it has not contacted any of the taxpayers with these outstanding checks, including the corporations with the 10 highest amounts. The Department believes that all outstanding checks have been received by the taxpayer but have not been cashed. All of the outstanding checks were cancelled in December 2002 as part of the State's expired check process; therefore, the taxpayer must contact the Department in order to have a refund check reissued.

In our Fiscal Year 2001 audit, we recommended that the Department immediately resolve the outstanding checks. The Department contacted the 183 taxpayers that had checks greater than $500, and reissued checks to these taxpayers, as applicable. Of the 183 taxpayers with checks over $500, 26 checks remained uncashed as of November 4, 2002. The remaining 13 checks that we noted were outstanding from the Calendar Year 2000 refund were for taxpayers who had checks that were less than $500. We provided suggestions to the Department to develop procedures to locate the rightful owners of the outstanding checks for future refunds. The suggestions included working with the county that originally provided the taxpayer information, posting the names of the individuals on the Department's Web page, and turning the outstanding checks over to the Treasury's Unclaimed Property section. As mentioned earlier, the Department did contact taxpayers with outstanding checks in Fiscal Year 2001, but the Department did not implement procedures to locate the rightful owners of outstanding checks for the Calendar Year 2001 refund.

The Department should consider whether it is viable to turn outstanding checks over to Treasury's Unclaimed Property section. Currently the Department has a statute in place that allows uncashed income tax refunds to be turned over to Unclaimed Property, but this statute does not apply to other types of tax refunds. The Department should consider seeking legislation to extend the statute to allow personal property tax refunds to be turned over to the Unclaimed Property section.

Recommendation No. 21:

The Department of Revenue should resolve outstanding check issues to ensure that taxpayers receive their personal property tax refunds in a timely manner by working with the General Assembly to extend legislation to allow personal property tax refunds to be turned over to the Treasurer's Unclaimed Property Section.

Department of Revenue Response:

Agree. By December 2004, the Department of Revenue will seek legislation implementing the Office of the State Auditor's recommendation regarding uncashed/voided business personal property tax refund warrants. The Department will also consider expanding that request to include other uncashed/voided business tax warrants.

Office of the State Treasurer

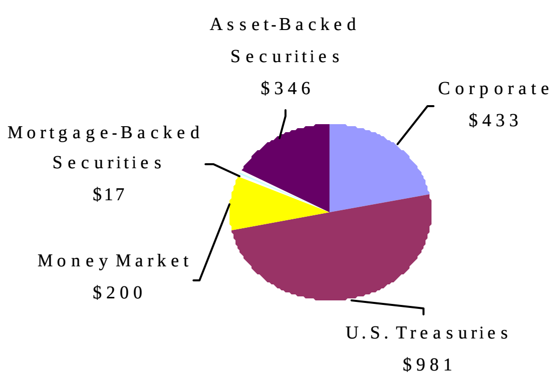
Introduction

The Office of the State Treasurer is established by the State Constitution. The Treasurer is an elected official who serves a four-year term. The Office manages the State's investments, and implements and monitors the State's cash management procedures. Other duties and responsibilities include:

- Receiving, managing, and disbursing the State's cash.
- Safekeeping the State's securities and certificates of deposit.
- Managing the State's Unclaimed Property Program, the School District Loan Program, and the Elderly Property-Tax Deferral Program.

The State's pooled investments are made up of a variety of securities as shown in the following chart:

Colorado Treasury Pool Portfolio Mix
June 30, 2002
(In Millions)



Source: Office of the State Treasurer records.

The following comments were prepared by the public accounting firm of Grant Thornton, LLP, who performed audit work at the Office of the State Treasurer.

Compliance With Colorado Funds Management Act

The Colorado Funds Management Act (the Act) under Section 24-75-901, C.R.S., was enacted to allow the State to finance temporary cash flow deficits caused by fluctuations in revenue and expenditures. Under the Act, the State Treasurer is authorized to sell Tax and Revenue Anticipation Notes (TRANS). TRANS are short-term notes payable from the future anticipated pledged revenue.

The Office of the State Auditor reviews information relating to tax and revenue anticipation notes and reports this information to the General Assembly as directed by Section 24-75-914, C.R.S. The following discussion provides information about the Treasurer's July 2, 2002, issuance of $800 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2002A Notes) and the November 25, 2002, issuance of $200 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2002B Notes).

Terms and Price

Both series of Notes have a maturity date of June 27, 2003, and are not subject to redemption prior to maturity. This date complies with the Act, which requires the maturity date to be at least three days prior to the end of the fiscal year of issue. The following table provides other details of the terms and price.

State of Colorado Details of Series 2002A and 2002B Note Issues		
Issue Amount:	2002A 2002B	$800,000,000 $200,000,000
Denomination (Both Series)		$5,000
Premium on Sale:	2002A 2002B	$11,579,500 $1,456,000
Face Interest Rate:	2002A 2002B	3.00% 2.50%
Average Interest Cost to the State:	2002A 2002B	1.532% 1.264%

Source: Office of the State Treasurer records.
Note: The average interest cost to the State was calculated by the Treasurer's Office based upon the net interest cost on each issue.

Notes in each series are issued at different face interest rates. These are the rates at which interest will be paid on the Notes. The average interest cost to the State differs from the face amount because the Notes are sold at a premium, which reduces the interest expense incurred.

Security and Source of Payment

In accordance with the Act, principal and interest on the Series 2002A and 2002B Notes are payable solely from any cash income or other cash receipts recorded in the General Fund for Fiscal Year 2003. General Fund cash receipts include those that are subject to appropriation in Fiscal Year 2003 and any pledged revenue, including the following:

- Revenue not yet recorded in the General Fund at the date the Notes were issued.
- Any unexpended Note proceeds.
- Proceeds of internal borrowing from other state funds recorded in the General Fund.

The State Controller records monies reserved to pay the principal and interest of the Notes in the Series 2002 Note Payment Account (Account) on the State's accounting system. The holders of the Notes are secured by an exclusive first lien on assets in the Account. The State Treasurer holds, in custody, the assets in the Series 2002 Note Account.

If the balance in the Account on June 15, 2003, is less than the principal and interest of the Notes due at maturity, the Treasurer must deposit into the Account all General Fund revenue then available and borrow from other state funds until the balance meets the required level.

The amount due at maturity for Series 2002A is $823,670,000, consisting of the Note principal of $800,000,000 and interest of $23,670,000. The amount due at maturity for Series 2002B is $202,944,444, consisting of the Note principal of $200,000,000 and interest of $2,944,444. To ensure the payment of the Series 2002A and 2002B Notes, the Treasurer has agreed to deposit pledged revenue into the Account so that the balance on June 15, 2003, will be no less than the amount to be repaid. The Note agreement also provides remedies for holders of the Notes in the event of default.

Legal Opinion

Brownstein, Hyatt and Farber, P.C., bond counsel, have stated that, in their opinion:

> The State has the power to issue the Notes and carry out the provisions of the Note agreements.
>
> The Series 2002A and 2002B Notes are legal, binding, secured obligations of the State.
>
> Interest on the Notes is exempt from taxation by the United States government and by the State of Colorado.

Investments

Both the Colorado Funds Management Act and the Series 2002A and Series 2002B Note agreements allow the Treasurer to invest the funds in the Account in eligible investments until they are needed for Note repayment. Interest amounts earned on the investments are credited back to the Account. The State Treasurer is authorized to invest the funds in a variety of long-term and short-term securities according to Article 36 of Title 24, C.R.S. Further, Section 24-75-910, C.R.S., of the Funds Management Act states that the Treasurer may:

Invest the proceeds of the Notes in any securities that are legal investments for the fund from which the Notes are payable.

Deposit the proceeds in any eligible public depository.

Purpose of the Issue and Use of Proceeds

The Notes are being issued to fund the State's anticipated General Fund cash flow shortfalls during the fiscal year ending June 30, 2003. The proceeds of the sale of the Notes were deposited in the State's General Fund. Note proceeds will be used to alleviate temporary cash flow shortfalls and to finance the State's daily operations in anticipation of taxes and other revenue to be received later in Fiscal Year 2003.

Additional Information

The Notes were issued through a competitive sale. A competitive sale involves a bid process in which notes are sold to bidders offering the lowest interest rate.

The Notes issuance is subject to the Internal Revenue Service's (IRS) arbitrage requirements. In general, arbitrage is defined as the difference between the interest earned by investing the Note proceeds and the interest paid on the borrowing. In addition, if the State meets the IRS safe harbor rules, the State is allowed to earn and keep this arbitrage amount. The Office of the State Treasurer is responsible for monitoring compliance with the arbitrage requirements to ensure that the State will not be liable for an arbitrage rebate.

State Expenses

The State incurred expenses as a result of the issuance and redemption of the TRANS. These expenses were approximately $173,731 for the Series 2002A and Series 2002B Notes. The expenses include:

- Bond legal counsel fees and reimbursement of related expenses incurred by the bond counsel.

- Disclosure counsel fees and expenses.

- Fees paid to rating agencies for services.

- Costs of printing and distributing preliminary and final offering statements and the actual Notes.

- Travel costs of state employees associated with Note issuance and selection of a financial advisor.

- Redemption costs, consisting of fees and costs paid to agents to destroy the redeemed securities.

No recommendation is made in this area.

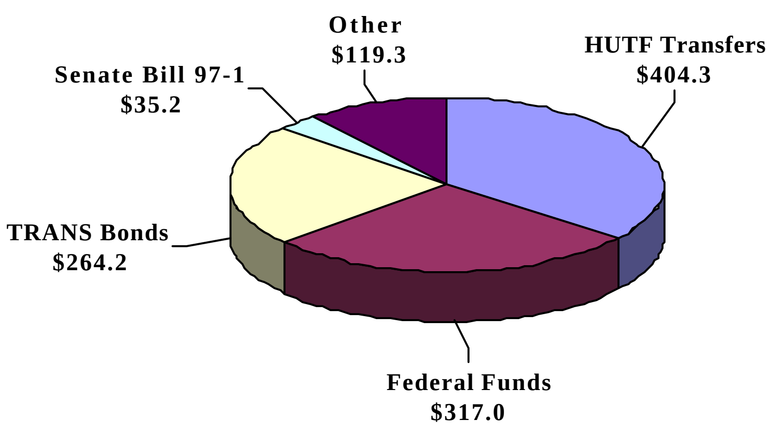
Department of Transportation

Introduction

The Colorado Department of Transportation is responsible for programs that impact all modes of transportation. The State Transportation Commission governs its operations.

In Fiscal Year 2002 about 41 percent of the Department's expenditures were related to construction funded by the Federal Highway Administration (FHWA) and state sales and use tax funds. The Department's portion of the State Highway Users Tax Fund (i.e., the State Highway Fund) and various aviation-related taxes fund most of its other expenditures. The Department also receives monies from other federal agencies that it passes through to local governments and other entities for highway safety and transportation improvement programs. The Department's Fiscal Year 2002 funding totaled $1,140 billion as shown in the following chart:

Department of Transportation
Fiscal Year 2002 Funding by Funding Source
(In Millions)



Source: Office of the State Auditor analysis of COFRS data.

Contract Oversight

In May 2001 the Department of Transportation (CDOT) entered into an intergovernmental agreement with the Regional Transportation District (RTD), the Federal Highway Administration (FHWA), and the Federal Transit Administration (FTA) related to the Southeast Corridor project. The Department defines the cost allocation between the Department and RTD for this project for the years 2001 through 2005 as shown in the following table:

Department of Transportation
Cost Allocation on Southeast Corridor Project
(In Thousands)

Responsible Party	Calendar Year					Total	Total Percentages
	2001	2002	2003	2004	2005		
CDOT	$108,004	$208,830	$215,980	$ 78,348	$ 48,592	$ 659,754	53.83%
RTD	17,859	96,525	119,161	155,490	176,737	565,772	46.17%
Total	$125,863	$305,355	$335,141	$233,838	$225,329	$1,225,526	100.00%
CDOT Percentage	85.81%	68.39%	64.44%	33.51%	21.56%	100.00%	

Source: Data provided by the Department of Transportation.

The agreement provided that as 2001 billings from the contractor came in, the Department was to pay 86 percent of the invoiced costs and RTD was to pay 14 percent. These payments were made to a third-party escrow agent, and the escrow agent paid the contractor.

We found that the Department paid $4.8 million in costs related to the project prior to June 30, 2001 which were actually the responsibility of RTD. During Fiscal Year 2001 the Department paid $30.6 million to the escrow agent for the project, based on the total invoiced amount of $34 million less retainage of $3.4 million. According to the agreement, the Department's share of the total costs for Fiscal Year 2001 was about $26.3 million net of retainage of $2.9 million and RTD's share was $4.8 million. We determined that the Department had paid RTD's share of the June invoices.

RTD subsequently repaid the amount owed in Fiscal Year 2002 by paying a greater share of future months' contractor payments. However, the reimbursement due from RTD was not recorded by the Department on the year-end books at June 30, 2001. This resulted in an overstatement of $4.8 million in expenditures on the Department's books for Fiscal Year 2001.

The Department's overpayment and unrecorded receivable resulted from a lack of oversight of invoices received to ensure that billings were consistent with the terms of the contract and that only costs attributable to the Department were paid and recorded on its books. Given the size of this contract, it is important that adequate monitoring of the contract is performed to determine that the proper amounts are recorded.

Recommendation No. 22:

The Department of Transportation should analyze invoices received for the costs incurred on construction projects and record the appropriate costs in accordance with the terms of the contracts.

Department of Transportation Response:

Agree. Payment documents are reviewed to determine appropriateness and compliance with contract terms. The situation identified related specifically to the initial payments for the Southeast Corridor project. Since that time, addition processing controls have been implemented. Implemented December 31, 2001.

The following comment was prepared by the public accounting firm of Grant Thornton LLP, who performed audit work at the Department of Transportation for Fiscal Year 2002.

Depreciation of Buildings

For Fiscal Year 2002 the State was required to adopt Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* GASB Statement No. 34 requires that certain long-lived assets, such as buildings, be capitalized and depreciated over their estimated useful lives. The majority of the Department's buildings have been in existence for many years. Since this is the first year of implementation, the Department had to estimate the remaining lives of existing assets and allocate the depreciation to prior and future years.

During our review of capital assets, we found that the Department did not record depreciation on its buildings. The historical cost of these buildings totaled approximately $62.1 million. By using a useful life of 100 years, we estimated that the Department should have recorded approximately $18 million in prior years' accumulated depreciation and approximately $700,000 in current year depreciation expense for those assets. The Department made the recommended audit adjustments and subsequently recorded the proper amounts on the State's accounting system.

In addition, the Department aggregated the historical cost of its buildings in making the estimate. While we do not anticipate any significant change from the estimates above, further refinements need to be done. Some buildings may warrant a longer or shorter useful life than 100 years. Some buildings do not meet the criteria for capitalization; that is, the historical cost does not exceed the threshold of $50,000. The Department should evaluate the useful lives of its buildings and whether all buildings should be capitalized and expensed over multiple years.

Recommendation No. 23:

The Department of Transportation should ensure the proper recording of capital assets by:

a. Calculating the estimated useful lives on all buildings using the guidelines outlined in the State Fiscal Procedures Manual.

b. Recording accumulated depreciation and depreciation expense using the straight-line method and the estimated useful lives as determined above.

c. Evaluating whether all buildings should be capitalized.

Department of Transportation Response:

Agree. Fiscal Year 2002 was the first year for the implementation of GASB 34. Considerable attention and work effort was expended in identifying, capitalizing, and depreciating the Department's capital assets and infrastructure. Detailed inventory records will be reviewed and adjusted as recommended. Implementation date June 30, 2003.